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Petition to Establish the Truth of Exceptions

By GEORGE F. BERNARDIN of the Boston Bar

The author, who is an associate in the firm of Goodwin, Procter and Hoar, wishes to extend his thanks to Frederick L. Quinlan, Esq., and Richard A. McLaughlin, Esq., for reading the initial draft and making many valuable suggestions.

Most attorneys are aware that they have a second chance to have a bill of exceptions allowed after it is disallowed in the Superior Court. But few have had any experience with this procedure, and the relevant statute and Court rules give but a bare outline of what it involves. During the past hundred years, however, the Supreme Judicial Court, which until early 1960 ruled on petitions to establish the "truth of exceptions," has gradually developed an extensive body of decisional law governing this procedure. Even though a statutory change in 1960 gave the task of considering these petitions to a single justice, this body of law will still be applicable. The purpose of this article is to attempt to collect and summarize this body of law, to point out some of the pitfalls and problems awaiting the unwary, and thus to show in some details how the truth of a bill is established.

Section 117 of G. L. c. 231 now provides:

> If the presiding justice, or another justice acting under section one hundred and fifteen [of G. L. c. 231, providing for another justice to rule on the exceptions if the presiding justice retires or becomes incapacitated], disallows or fails to sign and return the exceptions or alters any statement therein, and either party is aggrieved thereby, the truth of the exceptions presented may be established before *any justice of the Supreme Judicial Court* upon petition stating the grievance, and thereupon, the truth of the exceptions being established, they shall be *entered and* heard, and the same proceeding taken, as if the exceptions had been duly allowed and entered. The Supreme Judicial Court shall make rules for settling the truth of exceptions alleged and not allowed. *Such petition shall be filed with the clerk of the Supreme Judicial Court for Suffolk County.* (As amended by St. 1960, c. 207, § 4.) [Emphasis supplied.] [The emphasized words were added by the 1960 amend-

ment. The words "any justice of the Supreme Judicial Court" were inserted in place of the "the full court."]

On March 29, 1960, in pursuance of the statute, Rule 22 of the Fall Court was repealed and the following Rule Number 55 was added to the Common Law and Equity Rules:

> "Whenever a party seeks to establish before this court the truth of any allegations in a bill of exceptions which a judge has refused to allow and sign, he shall, within twenty days after notice of such refusal, file his petition with the clerk of this court for Suffolk County. The petition shall set forth in full such allegations and all material facts, and shall be verified by affidavit. The party filing the petition shall, within seven days after filing, give notice of the filing and a copy of the petition to the adverse party or his attorney of record. Notice shall be given in the manner prescribed in Rule 4 of the Rules for the Regulation of Practice at Common Law and in Equity. No party shall be allowed to establish the truth of such allegations in this court if he has failed to comply with this rule."

General

Before an excepting party is entitled to allowance of a bill of exceptions, he is expected to comply with the requirements of G. L. c. 231, § 113. This section directs the judge to "determine whether they [the exceptions] are conformable to the truth" and may allow the excepting party "to make such amendments to his bill as will make it a more accurate statement of the exceptions originally filed by him." The task of the judge is broader than the bare words of the statute indicate, for the test of the bill is "whether the exceptions . . . alleged were in fact saved, whether enough facts are stated to present the exceptions saved in their right perspective with reference to the issues tried and decided, whether the statement of the exceptions is uncolored and of sufficient brevity and whether otherwise it is true and fair." *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 474-475. A petition under § 117 is the only review available when a bill is disallowed because it is not true. See *Hicks* v. *Graves,* 194 Mass. 589; *Boston Bar Assn.* v. *Casey,* 204 Mass. 331, 335; *Jones* v. *Hayden,* 314 Mass. 519, 521-522. But, since it assumed the Legislature did not intend to preclude review when a bill is disallowed for other reasons, the meaning of the word "truth" in § 117 is construed as "broad enough to cover any case where a bill of exceptions is disallowed irrespective of the precise form of words used by the judge in disallowing it." *Scano, petitioner,* 338 Mass.

7, 8. In the *Scano* case the judge had disallowed the bill on the ground that it presented no questions of law. The court nevertheless would have considered the truth of the exceptions if any substantial question of law had been presented.

If, however, the excepting party has not complied with the procedural requirements for presenting the bill, such as giving notice to the other party, the bill is not properly on the files of the Superior Court and should be dismissed in that Court. *Gallagher* v. *Atkins,* 305 Mass. 261, 263, and cases cited. The dismissal can be reviewed by a wholly separate bill of exceptions. See *Day, petitioner,* 234 Mass. 576, 577; *Glick, petitioner,* 299 Mass. 255, 257; *Lincoln Elec. Co.* v. *Sovrensky,* 305 Mass. 476; *Boston Edison Co., petitioner,* Mass. Adv. Sh. (1960) 759, 762-763.

When the exceptions are allowed, there is also authority for the other party to move to dismiss in the Supreme Judicial Court. In several early cases where the exceptions were allowed and there was a question of whether the judge committed any error of law in deciding that proper notice had been given, his decision was reviewed by such a motion. *Conway* v. *Callahan,* 121 Mass. 165. *Browne* v. *Hale,* 127 Mass. 158, 161. *Purcell* v. *Boston, Halifax, & Prince Edward Island S.S. Line,* 151 Mass. 158. See *Spofford* v. *Loveland,* 130 Mass. 6; *Doherty* v. *Phoenix Ins. Co.* 224 Mass. 310, 312. It was said that the facts could be determined by an examination of the judge's certificate which was required by St. 1859, c. 196, § 27; Gen. Sts. c. 115, § 8; Pub. Sts. c. 153, § 10, and R. L. c. 173, § 107. In its most recent form this requirement was: "Exceptions shall be restored to the files of the court with a certificate, signed by the justice, allowing or disallowing them. If they are not so restored within ten days after they have been presented to him, the justice shall also certify the reason therefor." See *Moneyweight Scale Co. petitioner,* 225 Mass. 473, 478-479. The Court presumed, in the absence of proof to the contrary, that the judge had found all the facts necessary to allowance. The requirement of a certificate was, without explanation, not carried forward in the General Laws of 1921. Nevertheless it appears that the judge may still make a certificate which will be treated in the same manner as the statutory certificate. This, at least, appears to be the result of the case of *Glick, petitioner,* 299 Mass. 255, 257, which relied on *Day, petitioner,* 234 Mass. 576, decided when a statutory certificate was still required.

If the judge disallows a bill when he should have dismissed it, the remedy is still to bring a separate bill of exceptions. See *Harrington* v. *Tykeson,* 182 Mass. 584; *Day* v. *McClellan,* 236 Mass.

330, 331. It was said in *Day, petitioner, supra,* and *Glick, petitioner, supra,* that the petitioner can have a dismissal for failure to give notice reviewed in the Supreme Judicial Court on the basis of the certificate. This would be done by means of a petition to establish the truth of exceptions under § 117. *Gallagher* v. *Atkins,* 305 Mass. 261, 263-264. This approach is not available unless all the material facts as notice are given in the certificate, and in practice is not used.

Compliance with Rule 55

Before an excepting party can attempt to establish the truth of his exceptions he must comply with the procedural requirements of Common Law and Equity Rule Number 55.

"Whenever a party seeks to establish . . ."

The party must be " 'a party "aggrieved" by the failure of the presiding justice to allow exceptions which ought to be allowed,' *O'Connell, petitioner,* 174 Mass. 253, 255, that is, 'when the act or omission of the judge is erroneous.' *Meehan, petitioner,* 208 Mass. 60, 63." *Graustein, petitioner,* 305 Mass. 568, 568-569. The party who has no exceptions from rulings at the trial has no right to allege or present exceptions; he can only make suggestions at the hearing on the bill submitted by the excepting party and has no right to establish the truth of his own suggestions. *Browne* v. *Hale,* 127 Mass. 158, 162-163. He can, of course, argue against the exceptions as allowed. See *Dorr* v. *Schenck,* 187 Mass. 542, 543.

". . . before this court . . ."

This actually means that the truth of the exceptions are to be established before a single justice of the Supreme Judicial Court. See G. L. c. 231, § 117 (as amended by St. 1960, c. 207, § 4).

". . . the truth of any allegations in a bill of exceptions . . ."

It has already been noted that the issue in these proceedings is much broader than the truth of the allegations, and that the "truth" can be established no matter what the reason, if any, that is given for disallowance, unless it appears that the bill was disallowed for failure to comply with the procedural requirements for obtaining allowance of the bill. See G. L. c. 231, §§ 113, 114; Rules of the Superior Court Number 74 (1954).

". . . which a judge . . ."

Normally the judge who allows or disallows the bill must be the same judge who presided at the trial from which the exceptions

arose, but G. L. c. 231, § 115, provides that under certain circumstances, such as the death or disability of the presiding judge, "any other justice of the same court may examine and allow or disallow them."

". . . has refused to allow and sign, . . ."

Section 117 provides that a petition may be brought if a bill is not signed and returned as allowed. It follows that a bill can be allowed only by the act of the judge signing the bill and returning it, and an oral allowance is of no effect. As noted above, the statutory requirement of a certificate of allowance or disallowance (R. L. c. 173, § 107) was not carried forward in the General Laws of 1921. In *C. F. Hovey Co., petitioner,* 254 Mass. 551, 553, decided after the requirement of a statutory certificate was abandoned, Chief Justice Rugg said that a bill could not be allowed orally. Although he cited no authority for this statement, it seems likely that he concluded, from the continuing requirement of statute (§ 117) and rule (Rule 6 of the 1925 Rules for the Regulation of Practice before the Full Court), that since an allowance must be by the judge's signature, such a signature would be the equivalent of the signature on the statutory certificate that was no longer required. A bill can be disallowed by the judge's express disallowance, by his failure to sign and return the bill, or by his alteration of any statement in the bill. It should be noted that the allowance of an amendment is not an alteration. *Dorr* v. *Schenck,* 187 Mass. 542, 543-544, and great liberality is shown in permitting amendments to put the bills in proper form. *O'Connell, petitioner,* 174 Mass. 253, 256. *Graustein* v. *H. P. Hood & Sons, Inc.,* 293 Mass. 207, 213. *Graustein, petitioner,* 305 Mass. 568, 569-570. See *Hector* v. *Boston Elec. Light Co.,* 161 Mass. 558, 560-561.

A bill can be allowed only if it conforms to the truth; it will be treated as disallowed if the judge allows the bill for some other reason. *Harrington* v. *Boston Elev. Ry.,* 229 Mass. 421, 431-432 (bill allowed to avoid delay of sending case to commissioner). Occasionally a judge may take no action on a bill, and this too is deemed to be a disallowance, *Tourles, petitioner,* Mass. Adv. Sh. (1960) 1019, 1021 (involving a refusal to allow or disallow the bill). Or, he may merely give the excepting party leave to file an amended bill, pointing out the changes that would make the bill conformable to the truth. The original bill is treated as disallowed. *Rines, petitioner,* 331 Mass. 714, 715-717.

The excepting party can then forego pressing his original bill and file an amended or substitute bill which, if allowed as an

amendment but disallowed as not a true bill, he can attempt to establish under § 117. See *New England Transp. Co., petitioner,* 320 Mass. 331. The act of filing of a substitute bill is treated as a waiver of exceptions in the first that are not carried over. *Barnett, petitioner,* 240 Mass. 228, 230.

If the judge alters the bill and allows his altered version, his allowance is treated as a disallowance of the original bill. *Fletcher* v. *Sibley,* 124 Mass. 220, 222. When the judge allows a bill and then revokes his allowance (as he may do in appropriate instances before entry of the case in the Supreme Judicial Court) the revocation itself is not deemed to be a disallowance. See *Thorndike, petitioner,* 254 Mass. 256, 259-261. If he dismisses the exceptions instead of allowing or disallowing them, the excepting party cannot proceed under § 117, but must bring for allowance a separate bill of exceptions to the dismissal *(Glick, petitioner,* 299 Mass. 255, 257) unless the judge indicates that the bill was dismissed because it did not conform to the truth. In such a case the word "dismissed" is construed to mean "disallowed," and a petition under § 117 may be brought. *Ray, petitioner,* 314 Mass. 195, 197. If, however, the judge dismisses the bill without explanation, "it is not to be assumed that in ordering the bill of exceptions dismissed . . . [he] acted inadvertently and intended merely to disallow the exceptions because they did not conform to the truth." *Glick, petitioner,* 299 Mass. 255, 256.

". . . he shall, within twenty days after notice of such refusal, file his petition with the clerk of this court for Suffolk County."

When the judge takes affirmative action on the bill by making an express disallowance or taking any action on the bill that is deemed to be a disallowance, the excepting party has twenty days to file his petition after receiving notice of this refusal "to allow and sign." "Notice" means notice in the Superior Court—either actual or notice in accordance with Rule 74 of the Superior Court (1954), which can be accomplished by mail in conformity with Rule 3 of that court. *Siegel, petitioner,* 309 Mass. 553, and cases cited. There may be a problem in determining whether the judge's action constitutes a disallowance. For example, in *Fletcher* v. *Sibley,* 124 Mass. 220, the judge disallowed the bill presented to him and allowed a bill with alterations made by himself, evidently without the actual knowledge of the petitioner. It was held that notice to the petitioner that the bill had been allowed "was legal notice of the contents of the bill thereby brought to his knowledge and open to his inspection, especially when, as in this case, he previ-

ously understood that the exceptions were not to be allowed in the form in which he had presented them." 124 Mass. at 222. A problem may also arise in determining when the excepting party is deemed to have notice of a refusal if the judge takes no action on the bill, for there is no requirement of statute or rule that the judge must act upon a petition that has been presented to him within any particular time. Superior Court Rule Number 74 (1954). The bill can be kept alive if the excepting party presents the bill for allowance and files an affidavit that he has done so. Formerly, it was provided, by Rule 53 of 1923 Superior Court Rules, that after a three month period after filing without action, the clerk should notify the parties and judge "that unless within thirty days thereafter, *or within such further time as the justice may for cause allow,* the bill of exceptions is presented to the presiding justice for allowance *and is by him allowed,* it will be dismissed and judgment will be entered as though no exceptions had been filed." (emphasis supplied) Thus, although no time was specified within which an allowance had to be made, the time could be extended only "for cause." This explains the holding in *C. F. Hovey Co., petitioner,* 254 Mass. 551, 552-553, that the bill would be treated as disallowed when the time for allowance, not properly extended by the judge, had expired. See also *Bath Iron Works, Ltd.* v. *Savage,* 262 Mass. 123, where the judge took no action, but judgment was entered notwithstanding the exceptions because the excepting party after receipt of the notice under Rule 53 failed to press for a hearing and thus to do "all that he rightly could have done to secure the allowance." 262 Mass. at 126. Rule 74, which now governs, provides for the entry of judgment only if an affidavit that the exceptions have been presented has *not* been filed (within thirty days after the expiration of three months from the filing or such further time as may be allowed) *and* the bill is neither allowed or disallowed. The change in the rules is discussed in *Graustein* v. *H. P. Hood & Sons, Inc.,* 293 Mass. 207, 209-212.

Upon one occasion (prior to the enactment of the provisions for another judge to allow or disallow a bill, St. 1882, c. 239, now G. L. c. 231, § 115) when the judge took no action on the bill for more than a year after it was presented (during which time he had retired), it was held that the Superior Court had discretion to grant a new trial. *Borrowscale* v. *Bosworth,* 98 Mass. 34. Today this is not a problem, for another judge can allow or disallow the bill under certain circumstances. Nevertheless, even now an excepting party does not know when a bill is deemed disallowed if he diligently presents his bill for allowance in accordance with § 113 and

Superior Court Rule 74 (see *Attwood* v. *New England Tust Co.,* 305 Mass. 472, 474-475) and the judge is available to act on it, but fails to do anything. Evidently a judge can take no action on a bill for an indefinite period after it has been presented to him. Of course, if judgment is entered, then the time would run from that time even though no action has been taken on the bill *(Brown* v. *Gilman,* 115 Mass. 56) but judgment cannot properly be entered unless the exceptions are disposed of. *Browne* v. *Hale,* 127 Mass. 158, 161-162. Exceptions are considered disposed of if the excepting party does not use diligence in seeking their allowance. *Bath Iron Works* v. *Savage,* 262 Mass. 123, 126. See G. L. c. 231, § 114; *Flynn, petitioner,* 265 Mass. 310; *Buden* v. *Olson,* 317 Mass. 156, 157-159.

Within twenty days after notice of the refusal to allow the bill, the excepting party must file his petition and pay or tender payment of the entry fee. *Thorndike, petitioner,* 252 Mass. 154. In *Clemens Elec. Mfg. Co.* v. *Walton,* 168 Mass. 304, the petition was filed and accepted but the entry fee was not demanded and the person who brought the petition to be filed did not know that a fee was due. The court held that the bill had been seasonably filed even though the fee was not paid until after twenty days, since the clerk had not demanded it when he accepted the petition for filing. "A party cannot by filing subsequent motions and alleging other exceptions keep alive a case after the expiration of those twenty days." *Thorndike, petitioner,* 254 Mass. 256, 260. Nor can the judge, by entering a *nunc pro tunc* disallowance, deprive the excepting party of his twenty days. *Bullock, petitioner,* 254 Mass. 14, 16.

"The petition shall set forth in full such allegations and all material facts. . . ."

"What is here required to be set forth in the petition, as the grievance, consists of a statement of the exceptions that were presented in writing to the judge after being filed according to the statute, and an allegation that they were disallowed, or not signed and returned, although stated truly." *Bottum* v. *Fogle,* 105 Mass. 42, 43. The statement of the exceptions usually consists of a copy of the bill annexed to the petition. This copy of the exceptions apparently must also be signed. See *Lynch, petitioner,* 296 Mass. 598. The petition must allege facts bringing the petition itself within Rule 55. For example, it must allege that the petition was filed within twenty days after notice of disallowance. *Siegel, petitioner,* 309 Mass. 553. If the petition, though containing an averment that is superfluous and irrelevant, is otherwise good, it need not be dismissed. *Lyons* v. *Cambridge,* 131 Mass. 571.

". . . and shall be verified by affidavit."

"The signature of the petitioner, together with the jurat of an authorized magistrate that the petition has been subscribed and sworn to before him, has been held to be in compliance with the rule." *Thorndike, petitioner,* 244 Mass. 429, 431. The affidavit must be to the truth of the allegations in the petition, not merely to the truth of the exceptions. *Tufts* v. *Newton,* 117 Mass. 68. The affiant must swear that the statements in the petition are true; an affidavit "that the statements . . . are true to the best of . . . [the affiant's] knowledge, information, and belief" is insufficient. *Hadley* v. *Watson,* 143 Mass. 27-28. It is not necessary that the statement be verified by oath or affirmation "if it contains or is verified by a written declaration that it is made under penalties of perjury." Rule 6 of the Rules for the Regulation of Practice at Common Law and in Equity (1952). It is obviously insufficient merely to annex a jurat that the petition is acknowledged as the free act and deed of the petitioner. *Corey, petitioner,* 253 Mass. 498.

No averments may be inserted after the affidavit is made unless a supplementary affidavit is executed. Even though the original oath appears to apply to the whole petition, outside evidence is admissible to show that subsequent insertions have been made. *Fuller, petitioner,* 219 Mass. 209, 210. A defect in the affidavit cannot be cured after the twenty days for filing have passed. *Tufts* v. *Newton,* 117 Mass. 68.

"The party filing the petition shall, within seven days after filing, give notice of the filing and a copy of the petition to the adverse party or his attorney of record . . . in the manner prescribed in Rule 4 of the Rules for the Regulation of Practice at Common Law and in Equity."

This provision is the same as that contained in the November 4, 1955, substitution of Rule 22 of the Rules for the Regulation of Practice before the Full Court (1952). Prior to that time, Rule 22 provided that the petitioner must "not later than the day of the filing of his petition, give notice thereof to the adverse party. . . ." See *LaFond* v. *Registrars of Voters,* 296 Mass. 453, 454; *Boyajian, petitioner,* 310 Mass. 822. The copy of the petition must have the same contents as the original. Thus the copy must also contain a verification by affidavit so that the adversary will know that the petitioner is willing to take the responsibility for signing the petition. *Thorndike, petitioner,* 244 Mass. 429, 431-432. *Simmons, petitioner,* 314 Mass. 764, 765.

"No party shall be allowed to establish the truth of such allegations in this court if he has failed to comply with this rule."

It should be apparent in view of some of the holdings already mentioned, that complete and literal compliance with this Rule is necessary. These proceedings "always have been regarded as '*strictissimi juris,*'" the reasons given being: "because a judge is presumed to understand his rulings and to be fair in stating them, and because 'the judge whose statements are to be contradicted is not a party to the petition and is not supposed to be present in the hearing of the proof.'" *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 477. Whether these reasons have much relevance to the procedure for merely bringing the petition before the Supreme Judicial Court is open to question. Since, however, the determination of whether the exceptions are true may depend to a large extent on oral testimony and the recollection of witnesses *(Priest* v. *Groton,* 103 Mass. 530, 535-536), a requirement of strict compliance that eliminates undue delay in hearing the petition may have beneficial results.

Establishment of the Truth

Upon compliance with Rule 55, the petitioner must be able to show that his bill conforms to the truth in general and to the specific requirements of form that have emerged from the decisions of the Supreme Judicial Court.

As a preliminary matter, the petition must relate to the exact exceptions that were originally filed, seasonably tendered to the judge, and disallowed in whole or part. *Morse* v. *Woodworth,* 155 Mass. 233, 241. *Ryder* v. *Jenkins,* 163 Mass. 536, 537. *Freedman, petitioner,* 222 Mass. 179, 181. *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 476. *Barnett, petitioner,* 240 Mass. 228, 230. *Graustein, petitioner,* 305 Mass. 568, 570. If the petition does not conform to this requirement, it must be dismissed, for the petitioner cannot make amendments of substance to the petition [*Freedman, petitioner,* 222 Mass. 179, 181; *Reynolds, petitioner,* 253 Mass. 427, 428; *Tourles, petitioner,* Mass. Adv. Sh. (1960) 1019, 1021, see *Barnett, petitioner,* 240 Mass. 228), even though, as will be seen below, insubstantial errors may be corrected on motion of the petitioner. See *Bullock, petitioner,* 254 Mass. 14, 15.

Once the substance of the petitioner's exceptions becomes apparent, the single justice need not establish their truth if it is obvious that they have no merit and would be overruled by the full bench. This has not yet been said by the court under the new statute

giving power to the single justice to establish the truth of exceptions; but it would seem to be a logical step from frequent holdings under the former statute that even though the merits of the exceptions are not before the court on a petition to establish their truth, they will be considered and the petition dismissed if they present no substantial questions of law. See *Fitch* v. *Jefferson,* 175 Mass. 56, 57; *Bishop, petitioner,* 208 Mass. 405, 407-408; *Koch, petitioner,* 225 Mass. 148, 150; *Barnett, petitioner,* 240 Mass. 228, 230, 231; *Reynolds, petitioner,* 253 Mass. 427, 428-429; *Commonwealth* v. *Vallarelli,* 273 Mass. 240, 247-250; *Graustein, petitioner,* 305 Mass. 571; *Scano, petitioner,* 338 Mass. 7, 8-9. This decision, however, cannot be made by the presiding judge even though he is empowered to enter judgment if the exceptions are "immaterial, frivolous or intended for delay." G. L. c. 231, § 116. If exceptions have been dismissed below for this reason, the excepting party is still entitled to bring his petition to establish their truth to the single justice. See *Bullock, petitioner,* 254 Mass. 14, 15-16.

The exceptions themselves must be "substantially conformable to the truth" (*Crow* v. *Stowe,* 113 Mass. 153, 157), so that the questions of law can be adequately considered. They must set forth the material and important aspects of the circumstances out of which the questions of law arose. See *Ferguson* v. *Dean,* 132 Mass. 183; *O'Connell, petitioner,* 174 Mass. 253, 259-260; *Meehan, petitioner,* 208 Mass. 60, 63; *Energy Elec. Co., petitioner,* 262 Mass. 534, 537; *Boston, Worcester & New York St. Ry. Co., petitioner,* 320 Mass. 760. If the exceptions are too bare, they do not present a true picture of what happened below. See *Nielson, petitioner,* 236 Mass. 1, 4-5; *Rosen, petitioner,* 236 Mass. 321, 324-326. Verbal and unimportant variations from the truth "do not affect the substantial truth of the exceptions, or the right of the excepting party to have the rulings excepted to revised by [the Supreme Judicial Court]." *Markey* v. *Mutual Benefit Life Ins. Co.,* 118 Mass. 178, 192. See *Sawyer* v. *Yale Iron Works,* 116 Mass. 424, 432; *Clemens Elec. Mfg. Co.* v. *Walton,* 173 Mass. 286, 296; *Freedman, petitioner,* 222 Mass. 179, 181-182; *Ray, petitioner,* 314 Mass. 195, 198-200; *Tourles, petitioner,* Mass. Adv. Sh. (1960) 1019, 1021. "If such errors are found, which may fairly be attributed to inadvertence, and which do not essentially change the exception intended to be taken, or if there is an omission of details which can readily be supplied, and which ought to be added in order properly to present the exception relied upon, it is within the power of . . . [the Supreme Judicial Court, now the single justice] under a reasonable construction of the statute . . .

to suggest such needed amendments to the excepting party, and, if he adopts them, to allow him the benefit of his exceptions as thus modified." *Morse* v. *Woodworth,* 155 Mass. 233, 241. See *O'Connell, petitioner,* 174 Mass. 253, 256-257; *Melnick, petitioner,* 324 Mass. 524, 527, and cases cited.

The exceptions will be disallowed if they are not "reduced to writing in a summary manner" as required by G. L. c. 231, § 113. This requirement is mandatory, and, if the judge below does not perform his duty of disallowing exceptions that are too lengthy (see *Western Union Tel. Co.* v. *Fitchburg Gas & Elec. Light Co.,* 334 Mass. 587, 593), the single justice will dismiss the petition. Chief Justice Rugg has summarized this requirement as follows: "If the bill . . . as filed, although setting out exceptions actually taken, contains irrelevant and objectionable evidence of such a character as to obscure the questions of law raised, or is of wholly unnecessary bulk, or presents a picture changed in color by the insertion of some evidence and the omission of other evidence, then it is not a true bill." *Freedman, petitioner,* 222 Mass. 179, 181. Inclusion of a mass of irrelevant matter is not only burdensome to the court, but it also means that "the real questions raised at the argument . . . [may be] so covered up . . . as to involve serious danger that something material may be overlooked." *Isenbeck* v. *Burroughs,* 217 Mass. 537, 539. See *Churchill* v. *Palmer,* 115 Mass. 310, 314-315; *Cornell-Andrews Smelting Co.* v. *Boston & Providence R.R. Corp.,* 215 Mass. 381, 387-388; *Romana* v. *Boston Elev. Ry. Co.,* 218 Mass. 76, 81.

The problem then is for the single justice to apply this general test to individual cases. It is clear that there is no room in the exceptions for masses of extraneous matter. *Graustein, petitioner,* 305 Mass. 568, 569. *Rines, petitioner,* 331 Mass. 714, 719-720. In *Ryder* v. *Jenkins,* 163 Mass. 536, the exception was to the refusal of the judge to rule that, on all the evidence, the plaintiff had failed to make out a case. The exception was disallowed and then dismissed when the defendant tried to make the full transcript part of the exception. The objectionable stenographic report, consisting of eighty-two pages, was in considerable part "merely preliminary examinations of the witnesses in regard to their names, their relations to the parties and to the cause, and their probable prejudices, and of objections by counsel, and of colloquies between counsel or between court and counsel, which resulted in no ruling by the court." 163 Mass. at 538.

In summarizing the evidence, some latitude is allowed. It is

not fatal if the excepting party does not reduce all the relevant evidence to narrative form but rather relates questions and answers. *Clemens Elec. Mfg. Co.* v. *Walton,* 173 Mass. 286, 295-296. *Zacharer* v. *Wakefield,* 291 Mass. 90, 92-93. In the recent case of *Retailers Commercial Agency, Inc., petitioner,* Mass. Adv. Sh. (1961) 755, it was held that there had been substantial compliance with § 113 where a transcript of 323 pages was reduced to twenty-seven in the bill as printed in the record, about six of which were in question and answer form. But setting forth the evidence in question and answer form has been called "reprehensible" (*Cornell-Andrews Smelting Co.* v. *Boston & Providence R.R. Corp.,* 215 Mass. 381, 387); and where it appears that this method is given extended use, some justification may be called for. See *Conrad* v. *Mazman,* 287 Mass. 229, 237-238. At some point it becomes clear that no significant attempt to abbreviate has been made, and the exceptions should be dismissed. See *Taylor* v. *Pierce Bros. Ltd.,* 219 Mass. 187; *Rines, petitioner,* 331 Mass. 714, 719-720. Even though the single justice will allow a reasonable amount of room for leeway in his evaluation of the excepting party's attempt to summarize the evidence, if it appears that the petitioner has made no serious effort to put the exceptions in summary form, he cannot expect to have them established. See *Clemens Elec. Mfg. Co.* v. *Walton,* 173 Mass. 286, 295-296; *Rines, petitioner,* 331 Mass. 714, 719.

It may happen that, when presented to the single justice, some of the exceptions are conformable to the truth and others are not. Before his treatment of such a petition is considered, however, the duty of the judge below, when the bill is initially presented for allowance, should be reviewed.

A bill that is partially bad need not always be disallowed. "If the bill, as tendered to the presiding judge, contains several distinct and independent exceptions, clearly and separately stated, the truth of one or more of them may be established, although the others are not proved as alleged, or are waived by the excepting party." *Sawyer* v. *Yale Iron Works,* 116 Mass. 424, 433. See *Clemens Elec. Mfg. Co.* v. *Walton,* 173 Mass. 286, 296; *Randall* v. *Peerless Motor Car Co.,* 212 Mass. 352, 391; *Smith, petitioner,* 260 Mass. 297, 298-299; *Melnick, petitioner,* 324 Mass. 524, 527. The judge should be "very cautious" in disallowing an entire bill when it contains separable exceptions correctly stated. *O'Connell, petitioner,* 174 Mass. 253, 257. *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 479. *Melnick, petitioner,* 324 Mass. 524, 527. The judge appears to have discretionary power to decline separating the good from the

bad when the excepting party demands that the entire bill be allowed or disallowed. *O'Connell, petitioner,* 174 Mass. 253, 257. *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 479. Of course, he cannot actually amend the bill without the consent of the excepting party. G. L. c. 231, § 113. *Ray, petitioner,* 314 Mass. 195, 198, and cases cited.

When the bill is before the single justice, the time for amendment and redrafting is past; he has no power to allow amendments of substance. *Freedman, petitioner,* 222 Mass. 179, 181-182; *Barnett, petitioner,* 240 Mass. 228, 230; *Abelman, petitioner,* 313 Mass. 774; *Rines, petitioner,* 331 Mass. 714, 720; *Tourles, petitioner,* Mass. Adv. Sh. (1960) 1019, 1021. In *Tighe* v. *Maryland Cas. Co.,* 216 Mass. 459, it was held that the Supreme Judicial Court could not grant a motion to amend an *allowed* bill of exceptions to add a material statement, even though St. 1913, c. 716, § 3 (now G. L. c. 231, § 125), gave the court "upon any appeal, bill of exceptions, report, or other proceeding in the nature of appeal . . . all the powers of amendment of the court below." The proper procedure is to ask that the case be discharged from the docket of the Supreme Judicial Court so that it can be corrected by the judge. 216 Mass. at 461. See *Squier* v. *Barnes,* 193 Mass. 21, 24. This is because it is necessary to obtain the consent of the judge who allowed the original bill of exceptions. *Ashley* v. *Root,* 4 Allen 504, 505.

When the bill is disallowed and the exceptions are separable, one or more conforming to the truth, then the single justice will strike those that are bad and order the others established. See *Clemens Elec. Mfg. Co.* v. *Walton,* 173 Mass. 286, 296-297; *C. F. Hovey Co., petitioner,* 254 Mass. 551, 554-555; *Melnick, petitioner,* 324 Mass. 524, 527; *Nealon, petitioner,* 334 Mass. 213, 218. If omissions or other defects affect the accuracy of the entire bill, then the bill cannot be allowed even in part. *Ray, petitioner,* 314 Mass. 195, 198. *Maguire, petitioner,* 340 Mass. 12, 14-15. Exceptions that are not established before the single justice may be waived. See *Nealon, petitioner,* 334 Mass. 213, 218.

It has been assumed in this discussion that the excepting party was diligent in seeking allowance of his bill before the judge below. If, however, the judge gave the excepting party an opportunity to amend and he elected to stand on his whole bill, "the general rule that proceedings for the establishment of exceptions [before the Supreme Judicial Court, now the single justice] are regarded as *strictissimi juris* applies with peculiar force." *Rosen, petitioner,* 236 Mass. 321, 324-325. And the petitioner is not saved merely by acting

in good faith. *Ray, petitioner,* 314 Mass. 195, 198-200. There is no reason for the single justice to waste his time separating the true exceptions from the bad if the petitioner has not already made a reasonable effort to draft a true bill.

Procedure Before the Single Justice

(1) The preliminary hearing.

When a party has complied with the requirements of Rule 55, he is entitled to a hearing before the single justice who will determine whether the exceptions, if established, would present any substantial question of law. If not, as noted above, he will probably dismiss the petition. This defect can be brought to the justice's attention by motion to dismiss. *Snyder, petitioner,* 284 Mass. 367, 370. See *Commonwealth* v. *Vallarelli,* 273 Mass. 240, 246-247. "If no objection is made to the form, the time of filing or the service of the petition . . . [he may refer the bill] to a commissioner to hear the parties and to report to the court the facts bearing upon the question whether the truth of the exceptions is established." *Sawyer* v. *Yale Iron Works,* 116 Mass. 424, 432. There is no need to refer the petition to a commissioner, however, unless questions of fact are presented. *Vallavanti* v. *Armour & Co.,* 264 Mass. 337, 340. The findings of fact not disputed by petitioner must be taken as true. See *Commonwealth* v. *Vallarelli,* 273 Mass. 240, 246. When there is a question of what happened or was said at the trial, it is proper to refer the matter to a commissioner. But if the questions of fact are inconsequential and can be resolved by agreement of the parties, there is no need to do so. It may be necessary to refer the petition for a determination of whether the exceptions have been properly reduced to summary form, but if the single justice can decide from the face of the bill whether this requirement has been met, he will proceed to a decision on at least this aspect of the petition. Through this initial examination it should frequently be possible to eliminate many of the questions initally open, and so reduce to a minimum the controversies that the commissioner has to resolve.

Since "appointment of a commissioner is a remedy . . . intended only for cases in which the excepting party has attempted, intelligently and in good faith, but unsuccessfully, to obtain the allowance of a bill" *(Horan, petitioner,* 207 Mass. 256, 258; *Energy Elec. Co., petitioner,* 262 Mass. 534, 537; see *O'Connell, petitioner,* 174 Mass. 253, 259; *Rosen, petitioner,* 236 Mass. 321, 324-325; *Ray, petitioner,*

314 Mass. 195, 198-199), the single justice will satisfy himself that this condition has been met. In *Meehan, petitioner,* 208 Mass. 60, however, a commissioner was appointed even though the excepting party, failing to use reasonable diligence, did not present his bill for allowance until eight years after it was filed. The *Horan* case was cited but not discussed. 208 Mass. at 63. The petition was subsequently dismissed, the court saying that the excepting party would have to suffer the consequences of the fact that it became "impracticable to establish the truth of . . . [the] bill . . . to the reasonable satisfaction of the judge who . . . [considered] it." 208 Mass. at 65. In the *Meehan* case, the presiding judge died five years after the date of filing, and it was three more years before the bill was presented to the judge who disallowed it.

Upon appointment of a commissioner, unless some other arrangement is made, the petitioner must, within a reasonable time, apply to him to have a day appointed for a hearing; if the petitioner fails to do so, the exceptions should be dismissed. *Freeman* v. *Griggs,* 116 Mass. 302 (no excuse for sixteen-month delay).

(2) Proceedings before the commissioner.

The duty of the commissioner is to find the facts and report them. He cannot properly decide the ultimate question of whether the bill is conformable to the truth. *Cullen* v. *Sears,* 112 Mass. 299, 306-307. *Maguire, petitioner,* 340 Mass. 12, 14. Either party has a right to have the commissioner report the evidence to the single justice for his decision "if at the hearing before the commissioner there is a conflict of testimony, or a controversy as to inferences of fact to be drawn from the evidence." *Ela* v. *Cockshott,* 119 Mass. 416, 417. *Maguire, petitioner,* 340 Mass. 12, 14. When the parties do not ask the commissioner for a report of the evidence, the single justice himself may, on motion of the parties and in his discretion, recommit the commissioner's report to have this done. See *Kaiser* v. *Alexander,* 144 Mass. 71, 75-76.

The hearing before the commissioner is similar to one before a master or auditor. There is an important difference, however, in that a judge has already decided that the bill is not conformable to the truth. When the statutory certificate was required on the disallowance, it was said that the statute imported "such a narration as . . . [was] necessary to make clear the substantive nature of his final action and the pertinent facts upon which [the decision rested.]" *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 478. It was common practice to make such a certificate. *Id.* This certificate was

prima facie evidence that the exceptions did not conform to the truth, which would be rebutted by other evidence. *Bottum* v. *Fogle,* 105 Mass. 42. *Sawyer* v. *Yale Iron Works,* 116 Mass. 424, 432. *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 477-478. Considered as proper source of facts, it was disregarded to the extent that it went beyond its proper scope. *Id.* Although, as noted above, there has been no statutory requirement of a certificate since the enactment of the General Laws, of 1921, it has been assumed that the judge may still state the reasons for the disallowance and his statement will be treated in the same manner as a statutory certificate. See *C. F. Hovey Co., petitioner,* 254 Mass. 551, 553; *Glick, petitioner,* 299 Mass. 255, 256-257; *Tourles, petitioner,* Mass. Adv. Sh. (1960) 1019, 1021.

In *Glick, petitioner,* 299 Mass. 255, 257, the court said that unless a certificate were filed, the only way of seeing the facts to determine whether a dismissal of the exceptions was proper, is to examine the docket entries. Since a certificate was not required for a dismissal and at the time of decision was not required for a disallowance, the reasoning of the court is not altogether clear. Wouldn't any statement of fact by the judge be sufficient? Although, when the bill is dismissed, the issue is whether proper procedure has been followed rather than whether the bill is true, the evidentiary value of facts found by the judge would seem to be the same in either context. The answer, perhaps, is that the petition covers just the truth of exceptions in connection with the trial, and the single justice is not given power to revise the judge's findings of fact "upon the question whether the needful preliminary steps have been taken to entitle the excepting party to have his exceptions allowed." See *Spofford* v. *Loveland,* 130 Mass. 6, 7. Since the judge's findings of fact on notice and related matters are to be conclusive, perhaps it is best to require reference to a formal certificate or to the docket entries.

It now appears settled that if the judge makes an informal memorandum of allowance or in some other way states his reasons for disallowance, this will be given the effect of prima facie evidence. *Maguire, petitioner,* 340 Mass. 12, 14. The practical result of this is that the burden of showing that his exceptions conform to the truth is on the petitioner. The judge can, therefore, pin point the issues of fact by giving his express reasons for disallowance.

It has long been said that the judge who disallowed the exceptions should not be called as a witness in the hearing before the commissioner. *Bottum* v. *Fogle,* 105 Mass. 42. *C. F. Hovey Co.,*

petitioner, 254 Mass. 551, 554. The basis for the rule is not clear. The only elaboration of this rule expressed in the early case of *Bottum v. Fogle,* 105 Mass. 42, was that "the judge whose statements are to be contradicted is not a party to the petition and is not supposed to be present at the hearing of the proof." But this statement was apparently inserted to explain why the procedure for establishing a bill of exceptions must be strictly complied with. See also, *Moneyweight Scale Co., petitioner,* 225 Mass. 473, 477. In *Commonwealth* v. *Marshall,* 15 Gray 202, the commissioner took the depositions of the judge, but this matter was not discussed in the opinion of the court. In *Morse* v. *Woodworth,* 155 Mass. 233, 243-244, the judge was called and was cross-examined at length. The court said that it was unnecessary to call him, citing *Sawyer* v. *Yale Iron Works,* 116 Mass. 424. In the *Sawyer* case this point was not discussed, but considerable reliance was placed on the judge's certificate. In *C. F. Hovey Co., petitioner,* Chief Justice Rugg said that the judge should not be called, explaining that his presence was unnecessary because he has "ample opportunity . . . to state in the certificate of disallowance the facts controlling his mind." 254 Mass. at 554. Since the presiding judge need not file a certificate or otherwise state his reasons for disallowance and since, even if the judge does state his reasons, the parties have no control over the nature of his statement (*Moneyweight Scale Co., petitioner,* 225 Mass. 473, 479; *C. F. Hovey Co., petitioner,* 254 Mass. 551, 553), this reason does not seem to be very convincing.

The present state of the law appears to be that a judge may or may not, in his discretion, give the reasons for disallowance. If he gives no reasons, he cannot be called upon to explain his action. It is suggested that another approach is possible and may be preferable. Under G. L. c. 233, § 20, "any person of sufficient understanding . . . may testify in any proceeding . . . in court or before a person who has authority to receive evidence. . . ." To allow the judge to testify does not present the problem of the combination of the roles of judge and witness, a practice assumed to be improper in *Commonwealth* v. *Smith,* Mass. Adv. Sh. (1961) 373, 377. See Wigmore on Evidence (3d ed.) §§ 1805, 1909. The occasions when such testimony would be needed would probably be rare and the commissioner should be capable of preventing any under embarrassment to him.

The scope of the commissioner's report is determined by the order of reference. The usual order to the commissioner directs him to hear the parties and their evidence, to settle the truth of the

exceptions, and to make a report to the court. As noted above, he may be required to report the evidence.

(3) The hearing on the report.

Once the report is made, the single justice makes the decision of law whether the truth of the exceptions is established. If the commissioner reports that the exceptions are factually correct, the single justice will order the truth established. If the commissioner reports that insubstantial corrections should be made, or that one or more of the exceptions do not correspond to the facts, but are separable, the single justice will accept the improvements suggested and will strike those exceptions that are bad. *Clemens Elec. Mfg. Co.* v. *Walton,* 173 Mass. 286, 296-297. *Nealon, petitioner,* 334 Mass. 213, 218. When the truth of exceptions was established by the full court, it was said that it was not necessary to establish the truth of exceptions arising from questions not likely to come up in a new trial. See *Mark* v. *Stuart-Howland Co.* 226 Mass. 35, 46; *Barnett, petitioner,* 240 Mass. 228, 231. Whether or not a single justice will strike such exceptions is not clear.

(4) Subsequent proceedings.

If the petition is dismissed, the petitioner can bring separate exceptions to the dismissal to the full court; although, since the question before the single justice is largely one of fact, the petitioner may have little to be reviewed by the full bench unless he has submitted requests for rulings that present substantial questions of law. If the petitioner prevails before the full court it has not been decided how the case will then proceed. One possibility would be to remand the case to a single justice for further proceedings. Then, if he orders the truth of the exceptions established, an order to the Superior Court could be entered, which would enable the petitioner to proceed to have the exceptions entered to be considered on their merits by the full court. The other possibility is that the full court would hear argument on the merits of the exceptions at the same time that it hears argument on the exceptions arising from the refusal of the single justice to establish their truth. It could then decide whether the truth of the exceptions in the § 117 proceeding should have been established. And, if their truth should have been established, the court could proceed to decide the case on its merits. Perhaps this disposition is not contemplated by § 117, but it would seem to be an expeditious way to treat the case, and one not barred by the letter of the statute.

Tax Aspects of Gifts to Minors

By M. GORDON EHRLICH of the Boston Bar

The author is an associate in the Boston firm of Bingham, Dana and Gould. This article is based in part upon the author's paper, which appears in Proc. N. Y. U. 19th Ann. Inst. on Fed Taxation 729 (1961).

INTRODUCTION

In these times of high taxes and general prosperity much has been written and said about the glitter of the tax advantages which may result from gifts to or for the benefit of children. Lately, the gifted child has received a great deal of attention. The purpose of this discussion is to review generally some of the problems involved in making him gifted.

There is no question that substantial savings can be achieved by means of a sensible program of *inter vivos* gifts. Income tax savings are possible, since a child, or a trust for his benefit, is an additional taxpayer with a separate exemption and generally lower income tax brackets. Moreover, gifts may remove property from the taxable estate of the donor at little or no gift tax cost because of the $3,000 annual exclusion (IRC § 2503 (b)), the $30,000 lifetime exemption (IRC § 2521) and the gift splitting privileges (IRC § 2513) available to married taxpayers. Thus, a husband and wife may make gifts of $6,000 per year to each child and grandchild over and above their $60,000 aggregate lifetime exemptions without incurring any gift tax liability.

However, gifts to minors involve intricate tax complications and care must be exercised to avoid the numerous pitfalls along the way. Furthermore, it is fundamental that the very important non-tax considerations must always be kept in perspective in deciding whether and how to make gifts.

This paper will attempt to examine some of the tax considerations in the context of a hypothetical donor, a successful doctor, who has decided that he would like to institute a program of annual gifts to his three minor children. Since the doctor is in a substantial income tax bracket, he would like the income from some of his assets to be taxable at lower brackets. He is also mindful of possible estate tax savings and views these lifetime gifts as part of an over-all estate planning picture. He wants the money to be invested in securities and he hopes that the income and the future appreciation from the investments will help defray the increasing costs of college educations

for the children. He probably assumes that this is a simple matter and undoubtedly he is somewhat shocked when his tax advisor informs him of some of the problems and pitfalls. He is told to consider the following possible methods of carrying out his wishes.

OUTRIGHT GIFTS

On the surface, the simplest method would be outright gifts. The doctor might buy securities and have title taken in the names of his children. Generally this is *the least desirable* approach due to lack of legal capacity of minors, at least where significant amounts of property are involved.

If securities are put in the name of a child, the gifts are frozen since minors have no legal capacity. Therefore, the securities can not be sold, nor can the dividends be invested without serious legal and practical difficulties. Shattuck, "Practical Consideration of Legal and Tax Problems Inherent in Gifts to Minors," 31 *Bost. U.L. Rev.* 451 (1951).

In order to avoid these problems, guardians must be appointed by courts. Guardianships involve substantial expenses and complications. Guardians must be bonded and generally accounts must be filed and court approval received for every sale of property or disposal of income. These latter requirements often are satisfied by one petition to the court at the termination of the guardianship. Furthermore, investment powers of a guardian are generally restricted. Note, "Recent Legislation to Facilitate Gifts of Securities to Minors," 69 *Harv. L. Rev.* 1476 (1956).

Informal arrangements such as nominees are sometimes used, but they create uncertainties. These arrangements are liable to lead to litigation and they may have adverse tax consequences. If securities are registered in the name of a nominee who possesses no legal authority, the gift may be ineffective, since title may remain in the donor. If the parent holds property as "trustee" for the child, he might have difficulty proving the terms of an oral trust. Such a trust might be regarded as being revocable so that the income would be taxable to the parent under IRC § 671, 676.

Finally, there is the practical consideration of the disadvantages of outright ownership. The gifted child will some day grow up, become aware of "his property," and have ideas of his own as to the proper uses for the funds. And minors' ideas are not always wise or in accord with parental wishes.

Outright gifts create an additional problem if the donee should die before attaining his majority. In that event, an intestacy would

result and the property or some portion of it could come back into the father's estate, thus possibly defeating one of the purposes of the gifts.

Gift Tax Consequences

An unqualified gift to a minor is regarded as a gift of a present interest whether or not a guardian has been appointed. Therefore, such a gift qualifies for the annual gift tax exclusion provided for by IRS § 2503(b). It is only where the gift is accompanied by limitations on the present use and enjoyment of the property which are imposed by the terms of the donor's conveyance that a question arises. Rev. Rul. 54-400 (1954-2 CB 319). An outright gift to the parent as guardian also qualifies for the annual exclusion where the guardian is authorized to use the property for the support of the minor, regardless of his obligations under local law. *Briggs*, 34 TC No. 117, CCH Dec. 24, 373 (1960), Acq. 1961-11 p. 7.

TRUSTS

In order to meet the objections to outright gifts, our hypothetical doctor might create one of several types of trusts for the benefit of his children. Trusts avoid the problems of guardianship and allow a great deal of flexibility. It is for these reasons that they should be seriously considered, especially where substantial gifts are contemplated. Although the doctor's initial gifts may be relatively small, for example $1,000 to each child, it may be assumed that he hopes to add to them every year. Therefore, the expense of creating suitable trusts in all likelihood would be warranted under these circumstances.

Some of the available trust devices, as well as the Massachusetts Uniform Gifts to Minors Act, will be considered and compared, but before doing so, two major tax problems involved in trusts and custodianships for minors should be discussed.

SUPPORT PROBLEM

If the doctor plans to use the trust income or corpus to discharge his legal obligation to support his minor children, he will encounter serious *income* tax obstacles. In fact, there is a substantial danger that he will be taxable on some or all of the trust income.

Sections 677 and 678

Section 677 of the 1954 Code provides generally that a *grantor* will be taxable on the portion of the income from a trust which is in fact applied or distributed for the support and maintenance of a beneficiary whom the grantor is legally obligated to support. IRC

§ 677 (b) limits the liability of the grantor to a tax on only that part of the income which is in fact used to discharge his obligation of support. This is a liberalizing provision, first enacted in 1943, as a result of *Helvering* v. *Stuart,* 317 US 154 (1942) where it was held that a grantor was taxable on all of the income of a trust for his minor children merely because the income could have been used to discharge his obligations of support.

If trust income is accumulated and distributed in later years for this purpose, the grantor might find himself taxable on the accumulated income because of the operation of the throwback rules, if the accumulation distribution is in excess of $2,000. See IRC §§ 665-668. The throwback rules should be considered whenever distributions of corpus are contemplated.

Section 678 contains similar provisions where a person other than the grantor is a trustee and as trustee does apply trust income to discharge the trustee's legal obligation to support the beneficiary.

"Grandfather Trust" Regulation

One other provision to be considered in this connection is the so-called "Grandfather Trust" Regulation. Reg. § 1.662 (a)-4 sets forth the rule that if, *pursuant to the terms of a trust,* income is used to discharge a legal obligation of *any* person, the income so used is taxable to the person whose legal obligation is being discharged. Thus, if a parent has a duty to support his minor child, and a trust is set up by the grandparent so that income from the trust is used to pay for items which would be within the parent's support obligation, the parent would realize taxable income to that extent. This would be so even though the parent was not a trustee and had nothing to do with the creation or administration of the trust.

The rationale of the regulation is apparently based upon the economic benefit theory. It has been criticized and it appears to be somewhat questionable. Although the regulation has not been tested in the courts, the Internal Revenue Service has followed it and extended it in its published rulings dealing with the Custodian Statutes. Under these rulings, income derived from custodianship property, which is used to discharge the legal obligation of *any* person to support or maintain a minor, is taxable to that person under IRC § 61 regardless of the relationship of the donor or custodian to the donee. Rev. Rul. 56-484 (1956-2 CB 23); Rev. Rul. 59-357 (1959-2 CB 212). These rulings have been criticized as extending Reg. § 1.662 (a)-4 to situations which do not involve

trusts. Although some may think that the regulation and rulings go too far, they deserve serious attention in any tax planning.

Extent of Parent's Legal Obligation of Support

An important question under present law involves the extent of a parent's legal obligation of support. The Treasury Department regards this as a question to be determined by the laws of the several states. Reg. § 1.661 (a)-4. The first question is what is the parent's obligation when the minor has property of his own? The Treasury takes the position that a legal obligation of support exists "if and only if the obligation of support is not affected by the adequacy of the dependent's own resources."

Under the law of most states, property or income from property owned by a child can not be used for his support so long as his parent is able to support him. Annot., "Parent's Duty of Support as Affected by Child's Ownership of Estate," 121 ALR 176 (1939); Am. Jur. *Parent and Child* § 44.

Although there is very little available authority, this appears to be the rule in Massachusetts. Cf. *McGeary* v. *McGeary*, 181 Mass. 539 (1902). In most states, the father's obligation exists despite the minor's own property, whereas a different rule seems to prevail as to the mother, especially during marriage. Reg. § 1.662 (a)-4 recognizes the distinction between the duties of the father and the mother. Massachusetts cases do not appear to have spelled out the extent of a mother's obligation of support, but it may be presumed that Massachusetts would adhere to the majority view.

Therefore, in most situations, the particular expenditures of trust income must be examined in the context of the "obligation of support" imposed under local law. This is a nice phrase, but it is one which creates great uncertainty. Massachusetts law does not clearly set forth what is the parent's obligation of support.

Statutory provisions are of little help in this connection. There is an amorphous body of common law which tends to restrict the obligation to "necessaries." The cases in Massachusetts tend to take a limited view of a parent's obligation under this standard. See Gossells, "Gifts to Minors—Income Tax Consequences of Massachusetts Support Law—Caveat Donor," IV *Boston Bar Journal* No. 2, p. 13 (1960). In one of the few cases which discuss the question of whether a college education is a "necessary," the Massachusetts court held that, on the particular facts, such education was not a necessity even though it was not unreasonable considering the father's means and manner of living and the student's prospects in life. *Moskow* v. *Marshall*, 271 Mass. 302 (1930).

Cases which consider obligations of support in situations involving legal separations tend to take a broader view of a parent's obligation. The probate courts here are concerned with an equitable division of property. It is possible that the Internal Revenue Service would seek to use these cases in an attempt to broaden the common law definition of necessaries. Note, "Tax Aspects of the Obligation to Support" 61 *Harv. L. Rev.* 1191 (April, 1961).

Reg. § 1.662 (a)-4 suggests that a parent's obligation under state law may depend upon the family's *station in life* and upon the means of the parent. Because of the uncertainty of local law (i.e., Massachusetts law), it would indeed be difficult to predict with any degree of certainty whether a given expenditure would constitute an item of support. See Tomlinson, "Support Trusts and Gifts to Minors" (Report of Subcommittee of ABA Committee on Estate and Tax Planning), 97 *Trusts and Estates* 929 (1958). An item such as the cost of a college education might be regarded by the Tax Court as part of a parent's legal obligation, even though it is not a "necessary" under local law. In a decision involving a different issue, the Tax Court recently stated that "the generally accepted modern view is that a parent may be required to pay for his child's college education." *Raymond McKay* 34 TC 1080 (1960).

Interesting questions also may arise as to the effect of the size of the trust property on the parent's obligation of support. Presumably, the extent of a parent's obligation should be determined without regard to the income available from the trust. For example, a father has an annual income of $5,000 per year and his son is the beneficiary of a trust set up by the grandfather which pays him or applies for his benefit $15,000 per year. It would seem that the extent of the father's obligation of support should be determined on the basis of his income of $5,000. He should not be legally obligated to provide for his children in a manner beyond his means. Therefore, any expenditure of trust income which would not be in discharge of a "support obligation" of a man with a $5,000 income should not be taxable to the father. A contrary result would lead to an absurd tax burden on the father.

Contractual Obligations

Before leaving the definitional aspects of support payments, it may be noted that even if a particular expenditure is not deemed to be for support and maintenance under local law, it may nevertheless create very serious tax problems if the expenditure discharges a parent's contractual obligation. For example, it is not uncommon for parents to assume a contractual obligation to make tuition pay-

ments. Some private schools require parents to agree in writing to pay the child's expenses. If trust income is used to discharge this legal obligation and this is *not* an obligation of support, it might be argued that *all* of the trust income would be taxable to the parent who set up the trust under Section 677 (a).

Thus, if a particular expenditure is not deemed to be for "support" under local law, it could result in disastrous tax consequences if it discharges a contractual obligation of the parent. The protection of Section 677 (b) limiting the tax to the extent that income is in fact used for support arguably would have no application under these circumstances. Thus, all of the trust income might be taxable to the parent, even though only a small portion was used to discharge his contractual obligation. It would seem advisable therefore for parents to avoid contractual commitments wherever possible.

How to Avoid the Support Problem

Because of the dangers in the border-line areas involving support payments, it would be preferable from a tax standpoint if this problem could be avoided. One way of doing this is to provide for the accumulation of trust income during the child's minority. The ultimate distribution may come within the exceptions to the throwback rules provided for in IRC § 665 (b). Another is to provide that the income may be used only for luxury items which are clearly not within the realm of support. See Lauritzen, "Super Support Trusts," 1 *Tax Counselor's Quarterly*, No. 2, p. 26 (1957). If these measures are consistent with the donor's over-all objectives, they might be useful to prevent the income from being taxable to him. In certain cases, therefore, it will be possible to eliminate the support problem simply by limiting the use of the trust income.

However, in the case of our hypothetical doctor, as in the case of many others, it may not be feasible to restrict the use of the trust income. In some cases, clients may be willing to assume certain risks in this area, since even if they run afoul of the support problem the consequences are not likely to be worse than if they had done nothing at all.

Let us assume, then, that our doctor wants the trust income to be available for his children's education when they reach college age and that under applicable local law he might be deemed to be legally obligated to furnish his children with such educations because of his means and station in life. How can the trust income be made available for this purpose without making the doctor taxable on it?

Distribute Income to Minor

One possible approach which has been suggested is to have the *trustee distribute the income currently to the minor or invest it on his behalf.* Miller, "Appropriate Forms of Gifts to Minors," *Proc. NYU 16th Ann. Inst. on Fed. Taxation* 765 (1958). The income could be invested in government bonds in the child's name. Treasury Dept. Cir. No. 750, Revised §§ 321.8(b) and 321.9(g). The bonds may be cashed in by the minor after he has reached a sufficient age to understand the transaction. In some jurisdictions, income could be deposited in a savings account opened in the name of the minor. Under statutes enacted in many states, the minor could withdraw the money with or without a legal guardian at a reasonable age. See Mass. G. L. c. 167, § 48; c. 168, § 28. The child could thus use the income in his savings account as his own money for "support" items in later years. Since the payments would not be pursuant to the terms of a trust, presumably Reg. § 1.662(a)-4 would not be applicable.

Since the trust would have no accumulated income, the trustee presumably could also use all or part of the trust corpus for "support" items without the throwback rules creating income tax problems for the donor. It would be better taxwise for there to be no prior understanding that the money was to be restricted for these purposes. Some degree of practical control might be retained by keeping the passbooks for the children.

This approach has the disadvantage of requiring income distributions to the minor, either directly or in the form of investments in the minor's name. One of the questions it presents is whether the income can be reinvested in securities without the appointment of a guardian. It would seem that this would be very difficult to do, since the child is under a legal disability. The Massachusetts Uniform Gifts to Minors Act covers only transfers by adults. G. L. c. 201A, § 2. Therefore, the income may have to stay in a savings account or in government bonds instead of being reinvested in securities unless a guardian is appointed. Although an approach requiring current distributions of income may have practical disadvantages, it would, however, appear to provide a possible solution to the support problem.

In some cases it might be possible to avoid the support problem by having the mother create a trust with her own funds since she may have no legal obligation of support. However, the father would be taxable on the income used to discharge his support obligations if Reg. § 1.662(a)-4 could be successfully applied by the Internal Revenue Service.

ESTATE TAX IMPLICATIONS OF CHOICE OF TRUSTEE OR CUSTODIAN

The second major tax problem involved in gifts to minors arises from the estate tax implications of the choice of trustee or custodian.

If the grantor of a trust makes himself trustee, and retains the right to accelerate payments of corpus, the trust property will be included in his estate if he should die with this power. IRC § 2038. The includability would result from the power to make corpus distributions so that the grantor in effect reserved a power to terminate the trust.

The Internal Revenue Service has extended this to all gifts under the Custodian Statutes where the donor is custodian, apparently on the theory that the donor retains the power to withhold enjoyment until the beneficiary reaches the designated age. Rev. Rul. 59-357 (1959-2 CB 212); Rev. Rul. 57-366 (1957-2 CB 618). These rulings have also been severely criticized on the grounds that custodianships should not be treated as trusts. The rulings are inconsistent with the Treasury's position that transfers to custodians constitute completed gifts when made, which are eligible for the annual exclusion.

Therefore, the *grantor* or the *donor should not be trustee* or *custodian* if this estate tax risk is significant. Furthermore, the grantor of this type of a trust should not retain the power to replace the trustee and appoint himself as the successor trustee, since this would be regarded the same as if he had named himself trustee initially. *Van Beuren* v. *McLoughlin*, 262 F (2d) 315 (1st Cir. 1958); Reg. § 20.2038-1 (a) (3).

Other estate tax problems may arise if the father is trustee of a support trust since there are possible dangers under IRC § 2036 (dealing with transfers with retained life interests) and IRC § 2041 (dealing with powers of appointment) stemming from the possibility that the father trustee could use trust income to discharge his legal obligation of support. Lefevre, "Estate Tax Pitfalls in Trusts for Dependents," *Proc. NYU 16th Ann. Inst. on Fed. Taxation* 953 (1958). The Service has not gone this far in any reported case known to the writer.

In order to insure maximum safety, consideration should be given to the appointment of an independent individual or a Bank or Trust Company as Trustee or Custodian. In some cases, a practical solution may lie in the appointment of the child's mother as a trustee or custodian.

COMPARISON OF METHODS OF MAKING GIFTS

Although there are many ways of making gifts to minors without creating a guardianship, the four most popular methods are:

1. Short term (i.e. 10 year) reversionary trusts
2. The so-called Section 2503 (c) present interests trusts
3. Use of the Massachusetts Uniform Gifts to Minors Act
4. Section 2503 (b) trusts.

These four methods will be considered in the order set forth.

1. "10-year Clifford Trust"

Our doctor friend might transfer some securities to a ten-year trust. The income could be payable to or accumulated for the benefit of his children and after a ten-year period the trust could terminate and the securities revert to the doctor. IRC § 673. For an excellent discussion of these trusts, see Craven "Practical Uses and Problems of Short Term Trusts," *Proc. NYU 16th Ann. Inst. on Fed. Taxation* 903 (1958).

In order to avoid capital gains tax liability to the doctor, the trust could provide that the capital gains would be distributable and hence taxable to the income beneficiaries. Reg. § 1.643 (a)-3. This may or may not be desirable as a practical matter. A ten-year trust would allow income to go to the children, and be taxed at their brackets, without the necessity of making a gift of the securities themselves. The support problems alluded to earlier would apply to these trusts, and therefore they should be considered.

There is a gift of the value of the right to income for a ten-year period. If the trusts provide that all income is currently distributable, the value of the right to income qualifies for the $3,000 annual exclusion, or the $6,000 annual exclusion if the mother elects to have half of the gift treated as if made by her. Here, as in other types of gifts, the donor and his wife each have a $30,000 lifetime exemption.

Interesting valuation questions arise if the donees are given the rights to the capital gains of the trust. For example, must a gift tax be paid on all unrealized appreciation as of the date of the transfer since the donor has made it possible for the trustees to divert this property to the donees? Has the donor also made a gift of the right to future appreciation? Would the determination of gift tax liability be deferred until gains are realized? These questions are presently unanswered. The Service has recently announced that capital gains will be treated as additional gifts in

trust in the year they are realized, at least where the grantor is trustee.

The optimum use of ten-year trusts is probably limited to cases where donors have moderate estates. If the donor has a small amount of liquid assets, he probably can not afford to tie them up in trust. For example, a young couple owns some income-producing real estate. The husband is in a substantial tax bracket, and it would be desirable if the income from the real estate could go to their children so that it could be taxed at lower brackets, and so that more money will be available as a fund for education. However, because the couple has no appreciable amount of other property, they would probably reject a term trust, since they could not afford to part with their nest egg for the ten-year period.

On the other hand, for a prospective donor with a substantial estate like our doctor, a reversionary trust lacks the estate tax advantages which can be achieved by other forms of gifts. The value of the reversionary interest in the trust property would be includible in his estate.

However, as a practical matter, many people do not want to part with their property. Furthermore, gift tax problems may be minimized by this type of trust. Therefore, a gift to a short-term trust may be the only type of disposition that is acceptable. The resulting income tax savings may make such a trust very desirable. Thus, they are often used by high-bracket taxpayers even though they do not offer substantial estate tax savings.

2. Present Interest Section 2503 (c) Trust

A second type of trust to be considered is a present interest trust provided for in IRC § 2503 (c). Because of the uncertainty of prior law regarding the eligibility of trusts for minors for the annual gift tax exclusion, the 1954 Code provided in § 2503 (c) that certain transfers for the benefit of minors would not be gifts of future interests.

These trusts must provide that the property and income therefrom may be expended by or for the benefit of the minor before his attaining the age of 21 years. To the extent that it is not so expended, it must pass to the minor upon his reaching 21, and in the event that he dies before that age, the property must be payable to his estate *or as he may appoint under a general power of appointment.*

The Regulations, surprisingly, provide that this power of appointment may be exercisable by the donee by will or during his lifetime and that *it does not matter that a minor cannot exercise*

such powers under local law. Reg. § 25.2503-4 (b). Thus, it is possible to give the donee a power to appoint by will and to provide remainders over. In case the child dies before attaining 21, the power of appointment will be ineffective, since a minor lacks testamentary capacity in Massachusetts. G. L. c. 191 § 1. The property will go to the persons designated as remaindermen in the trust instrument.

In setting up these trusts, care should be exercised to conform to the regulations and the rulings of the Internal Revenue Service. The Service has taken the position that these trusts must terminate when the minor attains 21 unless the donee affirmatively elects to continue it. Rev. Rul. 60-218 (1960-1 CB 378). If the trust provides that it will automatically extend on after the beneficiary attains 21, unless he elects to terminate it, it would not qualify for Section 2503 (c) treatment, since it will not be considered as conferring upon the donee absolute ownership of the property upon reaching 21.

Another example of the fine lines which have been drawn in this area is the requirement in the regulations that there be no substantial restrictions under the terms of the trust instrument on the exercise of the discretion left to the trustee to determine the types and amounts of income to be expended for the minors. Reg. § 25.2503-4 (v) (1). Since these trusts involve the support problems alluded to earlier, it has been suggested that language be put in the trust instrument negating the possibility of the use of trust money for support. Such a restriction, however, would be likely to result in the loss of the gift tax exclusion, due to the provision in the regulations requiring complete discretion in the trustee. This illustrates the interplay between gift and income tax considerations and the possible conflicts that may result.

Two recent Tax Court decisions have opened up the possibility of qualifying gifts of income from trust property for § 2503 (c) treatment, even though the income may be accumulated during minority and even though the corpus of the trust is not distributable when the beneficiary attains 21. In *Jacob Konner* 35 TC—, No. 80, CCH Dec. 24, 651 (1961) a grandparent established § 2503 (c) trusts for the benefit of his grandchildren. Shortly thereafter the mother of the children created 10-year reversionary term trusts. The income of the term trusts was to be poured over to the trustees of the § 2503 (c) trusts. The Tax Court held that the gifts of the right to income from the 10-year term trusts qualified for the annual exclusion. In the companion case of *Arlean I. Herr* 35 TC—, 81, CCH Dec. 24, 652 (1961), the Tax Court considered gifts to trusts

for grandchildren which were to continue until the beneficiaries attained age 30. The trusts provided that the trustees could accumulate or distribute the income, but all income accumulated during the minority of the beneficiaries had to be paid over to them when they became 21. The gift of the income interests until majority were held to qualify for the annual exclusion, since the Court found that these gifts complied with the requirements of § 2503 (c). Despite the fact that § 2503 (c) requires distribution of the "property and income" by the time the beneficiary attains 21, the Court interpreted "property" as meaning only the income interest in this context. Although this result seems somewhat surprising in view of the statutory language, Judge Raum justified the result by resorting to an analysis of the Congressional intent underlying the enactment of § 2503 (c).

It is too early to evaluate the significance of these cases, for it is not yet known whether they will be accepted and followed by the Internal Revenue Service. The government has appealed the *Herr* case to the Court of Appeals for the Third Circuit. If these cases do become established as authorities which may be relied upon, they will offer a new approach for tax planners. Gifts of income interests alone could be made to qualify for the gift tax annual exclusion, either in connection with ten-year accumulation term trusts as in *Konner,* or they may be used in trusts similar to the ones involved in *Herr* which do not require a distribution of corpus at age 21. See Polisher and Aaron, "Herr opens way to exclusion for minor's income interest in a short term trust" *J. Taxation,* July, 1961 p. 41.

Thus, Section 2503 (c) trusts, if set up properly, can qualify for a full gift tax exclusion. The principal disadvantage of these trusts is the requirement that the property go outright to the minor at age 21. A portion of this problem may be mitigated if the *Herr* case is followed. Another problem is that the value of the trust property would be includible in the taxable estate of the minor if he should die before reaching 21. Despite these problems, these trusts are satisfactory if small amounts of property are involved. If larger sums are involved, other types of trusts should be considered.

3. Massachusetts Uniform Gifts to Minors Act

The Massachusetts Uniform Gifts to Minors Act (G. L. c. 201A) provides a mechanism which is analogous to the Section 2503 (c) trusts. This Act provides a vehicle for *outright* gifts to

minors of *securities* and *cash* only. It and its predecessor, the Model Gift to Minors Act, were sponsored by the New York Stock Exchange to provide a convenient and inexpensive method of giving securities to minors. The Uniform Act is broader than the Model Act in that it covers gifts of money as well as securities, and also because it allows any adult to act as Custodian. The Acts have been enacted everywhere.

In general, the Massachusetts Uniform Gifts to Minors Act provides that an adult may make a gift of a security to a minor by registering it in the name of the donor, another adult person, or a trust company as custodian for the minor. Gifts of money may be made similarly by delivering money to a bank or broker under a custodianship arrangement.

Gifts made pursuant to the act convey legal title to the minor of the security or money given, but the custodian manages the property. He is given discretion to pay over for the child's benefit so much of the custodial property as he deems advisable for the "support, maintenance, education, and benefit" of the minor. This is without regard to the duty of others to support the child and without regard to his other assets.

To the extent that the custodial property is not so paid out, it must be paid to the minor upon his attaining 21 or to his estate if he dies before that. It is not possible to provide remainders over in default of a power of appointment as in Section 2503 (c) trusts.

Gifts made in this manner are similar to those utilizing Section 2503 (c) trusts. The trust device would seem to be better in cases which involve gifts of any substantial amount. It is true that under the Custodian Statutes, no trust agreement or fiduciary tax returns are required, and apparently the throwback rules are not applicable. However, trust arrangements offer the following advantages over the statutory procedures for making outright gifts.

Trusts have advantages over custodianships. As indicated above, the Internal Revenue Service has ruled that the tax problems of using income from the property for support of a minor apply to a custodianship as well as to a trust. The language in the Custodian Statute, specifically providing for the use of funds for the "support and maintenance" of the donee, may make it more difficult to prevail if a question is raised in this area.

So also, a trust offers much more flexibility. A trustee can have much broader investment powers than a custodian. A custodian can hold only money and securities. He is bound by the prudent

man rule in his investments, except that he can retain the security originally given to him. It is questionable whether a custodian could properly reinvest in some of the glamour stocks currently selling at 100 times earnings, or whether he could subscribe to certain new issues.

These practical limitations need not be found in a trust, since a trustee may be given very broad investment and administrative powers. A trust may hold property other than securities and cash and the trustee may be empowered to participate in intra-family transactions. Furthermore, successor trustees can be nominated in the instrument, while successor custodians may in some cases require court appointments. G. L. c. 201A, § 7.

Perhaps most important is the fact that trusts (other than Section 2503 (c) trusts) may continue to be operative after the minor attains 21. In addition, they may provide for alternate dispositions in the event the beneficiary dies before reaching his majority.

Because of these factors, many people believe that the Uniform Act is useful primarily for small gifts where the limitations are not significant and where the establishment of a trust is not warranted. However, in cases involving substantial sums, the trust device deserves most serious consideration.

4. Section 2503 (b) Trusts

As indicated above, both the Section 2503 (c) trusts and the Massachusetts Uniform Gifts to Minors Act require payment of the donated property to the minor upon his attaining the age of 21. Because of this serious drawback, more and more people are considering and using trusts for gifts under IRC § 2503 (b). This trend will probably continue, especially if taxpayers are unable to rely on the *Herr* case, *supra*.

Section 2503 (b) trusts may provide that income is currently payable during the life of the beneficiary and they may give discretion to the trustee to invade corpus at any time for the beneficiary. They do not have to provide for automatic termination when the beneficiary attains 21. Provision may also be made in these trusts for a remainder over of any property remaining in the trust upon the death of the beneficiary.

To illustrate, suppose that our generous doctor sets up Section 2503 (b) trusts for each of his three children. The trusts could provide that the income would be payable annually to or for the benefit of the children for their lives, and the trustee could be given discretion to pay out part or all of the corpus to the income beneficiaries

at any time or at specified times. Thus, the trustee could make corpus distributions to pay tuition and similar expenses, i.e., he could terminate the trust when he felt this was appropriate. In the event one of the children should die before receiving all of the trust property, his trust could provide for a gift over to the other children or to the trusts for their benefit.

The actuarial value of the income right of the child would qualify as a gift of a present interest and hence qualify for the annual gift tax exclusion. The Commissioner's valuation tables indicate that the value of such a life interest is between 79% and 87% of the value of the donated property, depending upon the age of the child. Reg. § 25.2512-5 Table 1. Accordingly, a relatively small portion of a gift to such a trust would constitute a future interest and in many cases no gift tax would be payable because of the donor's $30,000 lifetime exemption.

These Section 2503 (b) trusts are subject to the same tax problems that arise from the desire to use trust property for support. Accordingly, caution is indicated here. However, the fact that income is currently distributed to the beneficiary makes it easier to avoid this pitfall. The donor should not be the trustee if he wants to keep the property out of his taxable estate.

The obvious advantage of such trusts is that the child does not have an unqualified right to the corpus at age 21. This may be a very important practical consideration since in many cases premature distributions of wealth have had adverse consequences. This factor may account for the surprising lack of popularity of the Section 2503 (c) trusts and gifts under the Custodian Statutes where significant amounts of property are involved. It must be recognized, however, that Section 2503 (b) trusts require competent and reliable trustees, for more discretionary powers are involved than in the other devices which have been considered. Furthermore, they involve slight gift tax complications because of the small proportionate future interests which they entail.

SUMMARY

In balancing these considerations along with those outlined earlier in connection with the 10-year and Section 2503 (c) trusts, the particular circumstances of each case must be controlling. This article has not done more than scratch the surface of some of the various forms commonly employed in making gifts to minors. Other types of trusts, such as spray trusts, which give the trustee discretion over the payment and accumulation of income, may be desirable in

cases where the additional flexibility is more important than the loss of the gift tax annual exclusion.

In summary, two basic tax principles should be remembered:

1. Beware of the support problem—if trust money must be used for this purpose, advance planning is desirable. One suggested approach is to provide for current distributions of income to the minor or to a savings account in the child's name. As the law presently stands, trust income, if currently distributed in this manner, may presumably be used in later years by the child as his own money. Apparently it is like good whiskey, since it appears to improve with age. After a period of time it should be regarded as the child's property, and it should lose its character as trust income.

2. Try to avoid the estate tax problems which might arise if the donor or settlor were to be named custodian or trustee.

These generalizations do not exhaust the dangers and pitfalls inherent in trusts or gifts to minors. The trust instruments and custodian arrangements must be set up with care, and of course, close attention must be paid to new developments in the law. In view of the uncertainty under the tax law as it now stands and the hodgepodge of state laws on the question of support obligations, it would seem that some of the problems in this area should be laid to rest by legislation. Unfortunately, no such clarification is in sight at this time. Finally, the importance of careful consideration of all of the practical aspects of making gifts to children can not be overemphasized, for the tail would be wagging the dog if the glitter of possible tax savings resulted in unwise dispositions of property.

Out of 50, Massachusetts and Her Annuity Tax Stand Alone

By ANNE P. PHIPPEN of the Boston Bar

Mrs. Phippen for some years has specialized in the legal problems associated with life insurance, and the related problems of taxation. She and her husband are also rearing five children, the youngest of whom was born only a few months ago.

Theoretically, a government could tax all income and all property. Traditionally and practically, this has not been done in most instances to preserve some incentive for labor and the investment of capital. Yet, Massachusetts in its taxation of annuities and insurance proceeds has not followed these economic theories. The purpose of this commentary is to consider the annuity and insurance phases of the Massachusetts income tax and the reasons for her singular position in this field among fifty states and the federal government.

THE MEANING OF THE WORD "ANNUITY"

Definitions

The concept of an annuity is not new—it dates back to early English law. Coke defined an annuity as "a yearly payment of a certain summe of money, granted to another in fee for life or years, charging the person of the grantor only." (Co. Litt. 144b) The years have not changed this basic definition, but they have added refinements and limitations according to the individual, business or governmental interest involved.

Today we speak generally of an annuity as a "right to receive a specific sum at regular intervals, usually contingent on the life of one or more persons, chargeable against a person or corporation and neither restricted to nor dependent upon the earnings or proceeds of a fund or business." (CCH Mass. Tax Repts., §§ 15.051.) Annuities may be created by gift or bequest, as a legacy in a will, through a private agreement or by purchase from an insurance company. They may be based on various contingencies, but historically and most commonly they are measured by life expectancies.

Kinds of Annuities

There are two main categories of annuities—regular and refund. Under a regular or straight annuity, payments continue during the lifetime of the annuitant or annuitants with all payments

ceasing at death. A refund annuity provides for regular installments to be paid during the life of an individual but guarantees a return of the investment if death occurs prematurely either by way of a single cash payment or a continuation of the payments to a named beneficiary.

These categories may be subdivided into four types as follows:

1. Joint or survivorship—payments are made during the lives of two or more persons, the income remaining level or subject to reduction by a specified fraction for the lifetime of the survivor.
2. Fixed period--installments are guaranteed payable for a predetermined number of years (the certain period) and for the remaining lifetime of the annuitant.
3. Deferred or retirement—the annuity may be any of the forms listed above, but payments do not begin until a fixed future date.
4. Variable—the periodic payments vary with investment experience, cost of living indices or similar fluctuating criteria.

Also classified as an annuity, although not usually sold commercially, is an arrangement involving payments for a term of years only, with all payments ceasing at the end of the specified period. Examples can be found in settlement options for insurance proceeds and in deferred compensation or salary continuation provisions in employment contracts.

The least common variety of an annuity is the so-called "private annuity," whereby regular payments are made pursuant to an agreement resulting from a sale or gift to or from a private individual or corporation. A problem of definition arises in these private transactions when the contract requires the income to be paid over a period of years only because such payments might be considered as income from an annuity, from an installment sale or from a deferred payment sale.

Importance of Defining an Annuity

The necessity for a clear definition becomes more pressing as annuities grow in popularity. Although not the most attractive investment in inflationary times, annuities are gaining favor with more and more individuals and businesses as a "hedge against the future." Several factors have contributed to this increasing demand for a guaranteed lifetime income. Policies connected with Social Security

have emphasized the value of a fixed after-retirement income. Deferred annuities have been one answer to problems arising from the increased life expectancies, which require basically the accumulation of a larger savings to meet retirement needs. The favorable tax treatment provided in the federal law and labor's demand for fringe benefits have stimulated the growth of pension, profit sharing and deferred compensation plans, all of which usually contain annuity provisions.

As more people receive this class of retirement income, the significance of annuity taxation will be intensified. Statistics indicate a steady rise in the percentage of citizens over 65 (the normal retirement age) over the next few decades. The average life expectancy is now 69 years. Today there are 17 million people over 65—five times as many as in 1900. By 1980 it is expected that United States will have 25 millions of age 65 and over—approximately 10% of the population.

Recognizing the problems presented by this increase in life expectancy, Congress has been considering projects and grants to assist these senior Americans who are affected to the greatest extent by the annuity tax. However, in addition to direct financial assistance to retired individuals, both the state and federal governments could offer a comparable indirect benefit by considering the inadequacies of the annuity tax structure to see how it could best be revised to fulfill revenue requirements without casting too great a tax burden on this older age group. If legislatures promoted investment in annuities through a more favorable tax program, it is conceivable that government aid to many of these elder citizens could be eliminated or considerably decreased.

An equally persuasive reason for reconsidering the basis of the annuity tax is the potential source of capital the funds invested in annuities offer for economic expansion. An increase in annuity form of savings would mean not only a present growth in investment dollars but possibly an eventual long-term tax savings as a result of greater private economic aid to underdeveloped parts of the world.

THE MASSACHUSETTS INCOME AND ANNUITY TAX

The Income Tax

To better understand the Massachusetts annuity tax, it is necessary first to consider the design of this state's personal income tax. Massachusetts levies a tax on the personal income, regardless of its source, of individuals, fiduciaries and partnerships domiciled in the state and also on certain classes of income received by non-residents.

Five specific classes of income are taxed. The rates are classified, not graduated as in the federal law, as follows:

Class of Income	*Ordinary Rate*	*Present Rate*
1. Dividends and interest (from certain intangibles)	6 %	7.38 %
2. Annuities	1½%	1.845%
3. Business income (from professions, employments, trade or business, including pensions, retirement allowances, commissions, fees, royalties and gains from the sale of capital assets other than intangibles)	1½%	3.075%
4. Gains (from the purchase or sale of intangible property)	3 %	7.38 %
5. Gains (from the public taking of real property within 1 year of taxpayer's acquisition, if such purchase were not made in good faith)	50 %	61.5 %

The present rate includes temporary additional taxes of 1% on business income and 3% on capital gains on intangible property plus a permanent 3% surtax for old age assistance and a temporary 20% surtax based on the tax assessed.

Some income is not taxed either because it is not within the five classifications or because it is exempt under the law. Also, there is no income tax assessed where income from all sources does not exceed $2,000 ($2,500 for a married couple).

The following exemptions and deductions are allowed against taxable income, depending upon its category:

1. Business Income—There is a specific exemption of $2,000 for a single person or a married person filing a separate return. On a joint return the $2,000 is increased by the amount of the business income of the spouse having the smaller income of this class, but not exceeding $4,000 total exemption. If the taxpayer and/or his spouse are totally blind, an additional $2,000 for each is allowed against income from professions, employments trade or business. Also deductible are $500 for a dependent spouse, $400 for each dependent child and business expenses such as interest, depreciation, repairs, etc.

2. Annuity Income—There is an exemption only where the total income (taxable and non-taxable) does not exceed $5,000 for a single taxpayer or $7,500 for a man and wife. The amount of the exemption is limited to the smaller of

(a) $1,000 ($1,500 if either party on a joint return has attained age 65) or (b) the unused portion of the business income exemption.

3. Interest and Dividend Income—Only the unused part of the annuity exemption may be applied against this type of income.

This classified system of income tax rates and exemptions has resulted in discrimination against Massachusetts residents receiving income mainly from annuities compared with those having principally business income. Because there are only limited exemptions and no deductions against annuity income, many retired individuals are bearing a disproportionate share of the total tax burden. In effect, they are being penalized for planning for their retirement.

The Tax on "Income from Annuities"

This discrimination is clearly evident in a closer examination of the Massachusetts annuity tax. The authority for the tax levy on annuity income is found in Chapter 62 of the General Laws, Section 5, which states: "On the amount by which the income from annuities exceeds the exemption provided in subsection (f) . . . there shall be levied . . . a tax of $1\frac{1}{2}\%$. The income of property held in trust shall not be exempted from taxation under Section 1 because of the fact that the whole or any part of the payments . . . is in the form of an annuity."

By its wording, the section presumes an understanding and agreement on the meaning of "income from annuities." However, the cases show that there is no general accord on the connotation of the phrase or even on the word "income" or "annuities."

According to Massachusetts decisions, income implies "a true increase in the amount of wealth which comes to a person during a stated period of time." *U. S. Trust Co.* v. Com., 299 Mass. 296, 13 N. E. 2d 6, cert den. 59 S. Ct. 359, 305 U. S. 659, 83 L. Ed. 427. See G. L. (Ter. Ed.) c. 62, § 1. Under federal law, income is referred to as "the gain derived from capital, from labor or from both combined." *Eisner* v. *Macomber,* 40 S. Ct. 189, 252 U. S. 189, 64 L. Ed. 521. In practice the word "income" eludes a simple, precise definition—rather its meaning is determined "case by case in the interplay of common usage, accounting concepts, administrative goals and finally judicial reaction." (Surrey & Warren, 66 Harvard Law Rev. 769.)

A similar divergency of opinion results from the discussion of what is "income from annuities." To many, it denotes the amount received over and above the cost or the investment; in other words,

a net profit. In that sense total income would vary with profit, whereas an annuity requires, in general, the payment of a fixed sum absolutely. Also, not all annuities are purchased so that there is a true "cost" basis, although indirectly annuities can be and are given a capitalized value. CCH Mass. Tax Repts, § 15.051-15.051D; 1954 IRC §§ 72, 2039, 2512, 2517.

The Federal Internal Revenue Code and most states have resolved this conflict of meaning by providing that each annuity payment consists of two parts—(1) a return of capital, which is not taxable as income and (2) interest. IRC § 72. However, this compromise is not followed in Massachusetts, and this is one of the reasons for its unique position in the field of annuity taxation in the United States.

With few exceptions, the Massachusetts policy is to tax the gross amount of each and every payment which is measured by the continued lives of one or more persons, but not to assess a tax on installments which are payable only during a fixed term of years. Although the Massachusetts law permits an exclusion for the capital element in taxing other classes of income, there is no such allowance for any return of the annuity investment. Neither is there an exemption granted where an annuity is received as a gift or legacy or from life insurance proceeds. Mass. Inc. Tax Reg., Annuities, adopted April 2, 1959.

Classification of Annuities in Massachusetts

To further complicate the taxable nature of annuity income, Ch. 62, § 5 (a) of the General Laws divides annuities into two categories: (1) those paid from property held in trust (which is taxed not as annuity income but according to the income from which payments flow) and (2) those from property not held in trust (taxable at the annuity rates). Moreover, a third category is indicated in § 5 (b) which provides that "retirement allowances" are taxable as "business income," unless specifically exempt by statute. PH Mass. Taxes, § 55.440.5.

HISTORY OF THE ANNUITY TAX IN MASSACHUSETTS

Prior to 1916

The roots of this unparalleled annuity tax design may be found in the Massachusetts laws of the 1800's. When the first annuity tax was enacted in 1836, the state legislature followed the pattern of the English statute, which taxed the total annuity payments. Ch. 7, § 4, 1836 Rev. Stat.

The General Court did recognize an exception, however, for annuities were taxable "unless the capital of such annuity should be taxed in this state." The exemption was allowed since the law was designed to reach property not held in trust. The purpose of the law was to supplement the basic tax on personal property, which in the 1800's was assessed on tangibles and intangibles by the town or city where the taxpayer was domiciled. *Gray* v. *City of Boston,* 15 Pick. 376; *Hunt* v. *Perry,* 165 Mass. 287, 43 N. E. 103.

Because then, as today, property tax rates varied in each locality, there were wholesale evasions of the tax. The taxpayer frequently used the simple device of establishing a domicile where the most favorable tax treatment was offered, even though his business and residence was actually at another location.

Moreover, administrative inequities abounded, both because of the appointment of unqualified and easily-influenced assessors, and because of the common and socially-approved reluctance of taxpayers to declare their intangibles and the true value of their property. Nicholas, "Taxation in Mass.," pp. 450-452; Barrett & Bailey, "Taxation," Mass. Pract. Ser. Vol. 4, § 1.

After 1916

To remedy these defects, the General Court in 1908 attempted to tax all intangibles at a uniform rate, but the legislation was held unconstitutional, as was a proposed law requiring the payment of a registration fee for intangibles, which was enacted in the following year. *Com.* v. *Adams,* 316 Mass. 484, 55 N. E. 2d 697. The final solution was the 44th Amendment to the Massachusetts Constitution, ratified in November, 1915, which authorized an income tax. The next year saw the enactment of the personal income tax law as Chapter 62 of the General Laws, which, with few changes, remains substantially in effect today. Mass. Stat. 1916, Ch. 269, effective 1/1/16; Whitehead, "Income Tax Law," 1 Mass. L. Q. 291.

The object of the new income statute was to establish a uniform rate for the taxation of intangibles but not to increase the burden of the tax on any class of property. Thus, a rate of 1½% on annuities was a continuation of the prior law at the approximate rate used over the previous eighty years, which had averaged 1.8%. The reason for the low rate on annuities was that the capitalized value of an annuity was less than the value of property producing an equivalent annual income. 1909 Stat., Ch. 490; Nicholas, supra, p. 451; *Tirrell* v. *Com.,* 287 Mass. 464, 192 N. E. 77, 1 Mass. A.T.B. 333.

Only once has the wording of the annuity tax in Ch. 62, § 5(a) been changed since its origin in 1916. This was in 1954 when

subsection (f) was added to provide for a limited exemption for the lower bracket taxpayer. 1954 Mass. Acts, c. 679. The initial 1½% rate for annuity income has varied (up to the present 1.845%) because of the addition of surtaxes, but the original premise of the annuity tax as a property assessment has not been altered measureably in over 125 years.

JUDICIAL AND ADMINISTRATIVE INTERPRETATION OF THE ANNUITY TAX

In their efforts to carry out the legislative intent prudently and equitably, the judicial bodies of Massachusetts have been hampered by the nineteenth century framework of the annuity tax and its conflict with the more lenient counterpart in the federal law. Taxpayers often sought their opinion to gain the annuity shelter—until 1951 only "business income" had a comparable rate of 1½%, and since that date only income in the annuity category has enjoyed the benefit of a tax rate under 2%.

However, the state courts did little to encourage taxpayer's seeking the haven of the annuity classification. Judges showed a strong reluctance to recognize income as an annuity if there were any part of the law under which it properly could be taxed. Furthermore, they were just as adamant in their opinions that all annuities should be taxed unless the General Court had specifically exempted the annuity income in question. *Tirrell* v. *Com.*, supra; *Staples* v. *Com.,* 305 Mass. 20, 24 N. E. 2d 641; *D'Arcy* v. *Com.* 2 Mass. *A.T.B.* 594; *Bruce* v. *Com.* 2 Mass. B.T.A. 444.

As a result of these views, payments which in other jurisdictions would be defined as annuity income, were taxed at various rates in Massachusetts, depending upon the state court's or the Commissioner's classification. As a consequence, there has been a perplexing hodgepodge of rulings and decisions—a confusing situation that is easily discernable from a review of Massachusetts' treatment of the different types of annuities.

Trust Annuities

Since income from a trust normally falls in the highest 6% bracket (as income from dividends or interest), a majority of the earlier decisions were concerned with determining whether such income in a particular case could be classified as an annuity. The issue was first argued in *Tirrell* v. *Commissioner* (1932-1934). The taxpayer contended that he was in receipt of annuity income because

the trustees of a testamentary trust had been directed to set aside a fund sufficient to pay him $250 monthly for life.

After carefully considering various annuity definitions and the history of the tax, the court concluded that the General Court intended to continue the annuity tax as construed prior to 1916—i.e., applying only to income of property not held in trust. This intention was evidenced, the court pointed out, in the language of the second sentence of § 5 (a): "The income of property held in trust shall not be exempted from taxation under section 1 nor shall payments to beneficiaries be taxed under this section because of the fact that the whole or any part of the payments . . . is in the form of an annuity." Therefore, it was held that the monthly payment from the trust was taxable not as an annuity but according to the class of income from which it was paid, regardless of the annuity form of the payments. (See Mass. Annuity Reg., § 1.)

Succeeding cases sustained this exclusion of trust income from the annuity classification, although the Appellate Tax Board in the *Tirrell* decision indicated that payments from the principal of an estate or trust could be taxed as annuity income. (See Barrett & Bailey, supra, § 360, where the authors suggest an annuity tax would occur if a trustee or executor were directed to purchase an annuity to provide funds to pay a specific legacy.)

Insurance Annuities

In their examination of the taxation of annuities from insurance proceeds, the Massachusetts courts encountered difficulties in distinguishing between the various types of annuities available under the options in the contracts and in differentiating between annuity payments made upon the surrender or maturity of a policy and those received as a death benefit by a beneficiary. Even today, this area of the annuity tax is unresolved and is subject to conflicting and questionable precedents.

The dilemma started in 1917 when the Massachusetts Supreme Court decided that insurance proceeds paid to a named beneficiary at death were not subject to the Inheritance Tax on the ground that the beneficiary's right vested when the policy was issued so that there was no taxable transfer taking effect in possession or enjoyment after the death of the Insured. *Tyler* v. *Treas. & Rec. Gen.*, 226 Mass. 306, 115 N. E. 300; 8 *Op. Atty. Gen.*, 1929, p. 538.

Until 1948 this exemption for life insurance was construed by the Massachusetts Income Tax Division to apply at either maturity or death, except (1) where proceeds were taken in installments for a fixed number of years wherein the excess over the face amount was

taxable as interest, and (2) where interest was paid on the amount left on deposit with the insurance company. Then in 1948 the Tax Board added another exception. It upheld the Commissioner's contention that where a beneficiary elects to have the insurance of her deceased husband paid to her as monthly life income, such payments are taxable as from any annuity. McKenzie, 1948 Mass. A.T.B. 1.

However, the validity of the position of the state taxing authorities has been questioned. The 1958 decision of the Massachusetts Supreme Court in *Allen* v. *Com.,* 337 Mass. 502, 150 N. E. 2d 14 lends support to the argument that insurance paid by reason of death to a named beneficiary is not taxable in any case. The holding in the *Allen* case overruled the Commissioner's theory that the interest element of a fixed installment option was taxable to the beneficiary. The court said, "The legislature has never imposed an inheritance tax . . . upon life insurance passing to a beneficiary . . . (and) . . . it would take very clear legislative language to lead us to hold that any part of the later payments, to which the beneficiary became absolutely entitled at the insured's death as principal amounts, was intended to be taxed under Ch. 62, § 1 (a)." See Mass. Inc. Tax Ruling #21, effective 7/11/58.)

The *Allen* case would seem equally applicable to the opinion that death proceeds of an insurance policy paid in the form of a life annuity should not be subject to an income tax. (Under the *McKenzie* ruling, the entire amount of each payment is taxable to the beneficiary at annuity rates.) In spite of the *Allen* decision, the Annuity Regulations still hold that income from life insurance proceeds which is based on life expectancy is taxable.

The same inconsistent pattern of taxing insurance proceeds is found in Massachusetts' treatment of the remaining installments paid to a surviving beneficiary under a joint annuity and those due from a refund annuity. Annuity payments, continued after death to the survivor of a joint annuity remain taxable as annuities, whereas the balance of the amounts from a refund type are exempt from tax. Thus far, there have been no cases to sustain this view as stated in section 6 and 7 of the state Annuity Regulations.

Another distinction is made by the Commonwealth in the inheritance taxation of the death proceeds from life insurance and those from an annuity. Life insurance, except where payable to an insured's estate, is exempt, and this exemption is applicable even if the proceeds are paid to a revocable trust. *Welch* v. *Com.,* 309 Mass. 293, 34 N. E. 2d 611.

Yet, the Massachusetts courts have approved an inheritance tax on the amount payable at death from an annuity contract prior to its maturity date, even though such a policy also contained a type of death benefit. *Gregg* v. *Com.* 315 Mass. 704, 54 N. E. 2d 169. The *Gregg* decision is difficult to reconcile with the language of the cases exempting life insurance proceeds, since in both instances the beneficiary obtains a present contractual right at the time the policy is issued so that there is no transfer taking effect at death. There were no clear-out grounds for the court's refusal to extend the life insurance exemption to an annuity policy—it reasoned that since the company was not paying out more than it received there was no insurance to be excluded. Therefore, because the deceased also retained the right to change the beneficiary and the manner of payment of the death or maturity proceeds, the court concluded there was a transfer taking effect after death subject to the succession tax.

In addition to these conflicting rules, there are several areas in the taxation of death benefits from insurance and annuity policies where no court decisions, rulings nor regulations have been handed down. It is not certain whether death benefits from insured private pension plan should be considered exempt life insurance or taxable annuity proceeds. An example of this doubtful area is where the pension is funded with a combined life insurance-deferred annuity policy and the proceeds become payable prior to the time when the annuity value exceeds the face amount of the contract so that a portion of the benefit would qualify as life insurance.

Similar questions arise in the taxation or exclusion of the vested portion of a profit sharing plan which is payable at the death of an employee. While there are no decisions in point, it has been suggested that the non-vested portion of a profit sharing plan should be exempt from the inheritance tax on the ground it is comparable to the exercise of a power of appointment, which in Massachusetts is not taxable in the donee's estate. Barrett & Bailey, supra, § 65; Vol. 4A, § 1038; *Dexter* v. *Com.*, 316 Mass. 31, 55 N. E. 2d 226.

Whether the Commissioner would ever argue for an inheritance tax on insurance or annuities as gifts made in contemplation of death is a moot question in the Commonwealth. G. L. c. 65, § 1. There is no indication that he is contemplating the use of such a theory either as to the total proceeds of a life insurance policy or as to the part proportionate to the premiums paid within two years of death. Barrett & Bailey, supra, § 1060.

Retirement Annuities

In its treatment of retirement annuities and pensions, Massachusetts again take an unconventional tax approach. Such payments are termed "retirement allowances," and unless exempt by statute, they are taxable under Ch. 62, § 5 (b) of the General Laws as "business income" rather than as "income from an annuity."

This classification was established by the state Supreme Court in *Everett* v. *Commissioner,* wherein the court stated, "If the payments have their source in the nature of further compensation for services rendered and are made directly or indirectly by the employer, then they are retirement allowances." 317 Mass. 612, 59 N. E. 2d 186. Nor does the fact that the pension comes from a commercially-sold annuity contract remove such payments from the business income category. *Mansfield,* 1945 Mass. A.T.B. 97. However, an exception is made where an employee releases his employer from an obligation to pay retirement benefits in exchange for an annuity contract; then the payments are taxable as annuity income. *Com.* v. *Hale,* 315 Mass. 556, 53 N. E. 2d 675.

According to the Regulations, retirement benefit from an employment plan are business income "whether the annuity is purchased before or after employment ceases and whether the plan was contributory or non-contributory." Annuity Reg. § 4. Under this ruling, an employee is not allowed to recover any of his investment in the plan, even though his contributions were included in his taxable business income at the time they were made. (See G. L. c. 62, § 8 (i), which exempts from an employee's business income amounts paid by his employer as contributions to a qualified deferred compensation plan.)

Furthermore, all payments from a pension, profit sharing or other employee benefit plan, whether paid in installments or in a lump sum at termination of employment or at retirement, are considered by the Tax Commission to be taxable business income in the year of receipt. There is no provision for the capital gain treatment of a lump sum distribution in such cases as in the federal statute. Business Income Reg. § 2 (c), effective 9/12/57.

In contrast to its position on the taxability of benefits paid to an employee, the Tax Commission has indicated it probably would not tax as business income the amount paid under a plan to a surviving spouse beneficiary, since she had not furnished any services to the employer. CCH Mass. Tax Repts., § 15.201.80, citing a letter from the St. Tax Com. dated 12/22/59.

Some employee retirement payments are specifically excluded

from business income under the statute. These include pensions received by non-residents, those paid by the Commonwealth or its political subdivisions, a police or fire department of a Massachusetts town, certain private and bank employee associations and amounts from the Railroad Retirement Board, Veterans Administration or the Social Security Administration. Bus. Inc. Reg., § 3; *St. Tax Com.* v. *Gray,* Mass. Adv. Sh. (1960) 395, 165 N. E. 2d 404.

Gift of an Annuity

If a Massachusetts resident receives an annuity contract purchased from an insurance company as a gift, the income therefrom is taxable to the donee at annuity rates. However, if the donor gratuitously promises to pay the donee a specified income for life, there is no tax liability to the donee because the element of personal obligation is lacking. Annuity Reg. § 1.

This Regulation is hardly consistent with the reasoning of the courts that the gift of the income from an inter vivos or testamentary trust payable to the donee for life is taxable to the donee, not as an annuity, but according to the income from which it is paid. Likewise, its conclusions seem to contradict the presumption that gifts are not included in taxable income since they are not so classified as subject to assessment in Chapter 62 of the General Laws. Hawley, 2 Mass. A.T.B. 657.

Alimony Annuity

To date there are no Massachusetts cases on the taxability of alimony income received in the form of an annuity. The Regulations state that if an annuity is purchased in discharge of a spouse's obligation of support, the income is taxable to the annuitant. Annuity Reg., § 3.

Yet, the ruling seems to be in direct conflict with the 1939 holding of the state Supreme Court that alimony payments from the income of a trust established pursuant to a separation agreement were taxable neither to the wife nor to the husband. *Com.* v. *Dalton,* 304 Mass. 147, 23 N. E. 2d 147. If the court could find that such trust income paid as alimony were exempt from tax (ordinarily all trust income is taxable), it would seem to follow that annuity payments made according to a divorce or separation agreement should also be considered non-taxable.

It has been suggested that the income from an alimony trust or annuity could be taxable income to the one liable for the alimony payments on the grounds that such income was constructively received and used to discharge a legal obligation. Barrett & Bailey,

supra, § 239; § 361. However, neither the Massachusetts courts nor the Commissioner has adopted the theory of constructive receipt of income. CCH Mass. Tax Repts. 15.204.19.

Private Annuity

If property is sold or donated to a charity, to an individual, or to a taxable corporation in exchange for the payment of a fixed income for life, each installment is considered taxable in full as an annuity under Massachusetts law. This principle originated in the 1929 Supreme Court's decision in *Bacon* v. *Commissioner,* which classified as annuity income annual installments of $52,000 payable to the taxpayer for life on the sale of his partnership interest. 266 Mass. 547, 165 N. E. 664. The court discussed neither the theory of a return of capital nor the possibility that the transaction was subject to a capital gains tax. There seems to be no logic in taxing the total amount received on a sale where the consideration is paid in the form of an annuity. The law itself, the cases and the regulations all permit a recovery of basis before computing the taxable gain on a sale or exchange of tangibles or intangible property. G. L. c. 62, § 5 (c); Annuity Reg., § 8.

In practice, the State Tax Commission does not actually follow the entire holding in the *Bacon* case. It has indicated that only the "profit" from the sale of a partnership interest is taxable, although it has not definitely decided whether the net proceeds are business income from the sale of intangible property or capital gain from the sale of an intangible. (Sales & Exchange Reg., adopted 7/6/58). However, there are no cases or regulations reversing the Supreme Court's rule that the full amount of sale proceeds payable in the form of an annuity is taxable income as received. Even the addition of section 63 to Chapter 62 of the General Laws, which authorizes the installment method of reporting a sale, does not prohibit an installment payable for life from being classified as annuity income since a payment plan for a term of years only has never been considered as an annuity in Massachusetts. Section 63, however, does add weight to the argument that a part of each payment should be excluded as capital.

Where the annuity is paid by a charitable organization in exchange for property there would be no tax benefit under the federal law. Under the rule of the *Bacon* case, there would be no adjustment for basis so the full amount of each payment would be taxed as annuity income. There is also no deduction for a contribution to a charity since this is not provided for by the Massachusetts income tax.

In this private annuity area, there is some danger that an additional tax may be assessed on the sale or exchange because of the possible application of section 5 (c) of Ch. 62. This would be at the capital gain rate of 7.38%. The theory would be that there had been a "sale, purchase or exchange of intangible personal property"—the intangible property being either the property sold or exchanged or the annuity purchased. In such a situation involving possible double taxation, justice would seem to require some allowance for recovery of the original investment by the taxpayer (an adjustment to basis is recognized under section 5 (c)). Whether the recovery of basis would also be permitted on receipt of the annuity income is an unresolved question. Under present case law and the regulations, it seems unlikely that this type of annuity would be given preferential treatment.

COMPARISON OF MASSACHUSETTS TAXATION OF ANNUITIES WITH THE FEDERAL LAW

Before 1934, all income from an annuity was considered to be a return of capital under the federal income tax law. Annuity payments were, therefore, tax-free until the sum of the payments received equalled the cost of the annuity; then payments were taxed in full at ordinary income rates.

From 1934 to 1954, a 3% rule was used. This method required the inclusion of 3% of the consideration paid in each annual return until the excluded amount exceeded the investment. Thereafter the entire amount was taxable as ordinary income. 1939 IRC § 22 b (2).

The 1954 Code radically changed this method of calculation which had not proved satisfactory. The new provision stipulated that the capital invested should be spread over the expected period of the annuity payments. The "exclusion ratio" for the investment is determined by dividing the cost by the total expected return, and this ratio is then applied to each payment to determine the amount of the non-taxable capital return. 1954 IRC § 72 (b).

Lengthy section 72 of the 1954 Internal Revenue Code, outlining the annuity tax, sharply contrasts with the two sentence law in Massachusetts. However, like Massachusetts, the federal code has no precise definition of an annuity—it only makes clear that an annuity includes payments for a fixed period as well as those based on life expectancy. The regulations under section 72 attempt a partial definition which is phrased only in general terms. Reg. IRC 1.72-2a (1); 1.72-1b; 1.72-2b (2).

On most phases of annuity taxation, the federal statute presents a different set of rules and concepts from those of Massachusetts. Subject to the exclusion of the allowance provided by § 72, the Internal Revenue Code taxes as annuity income most pension and retirement benefits as well as installment payments from the surrender of life insurance or endowment policies. There is no exemption for alimony annuities, which are taxable to the annuitant, 1954 IRC § 72 (k), nor for the interest element of the death proceeds of insurance payable for a term of years or for life. § 101 (c) 1954 IRC. Private annuities from the sale, exchange or gift of property are usually considered subject to the annuity rules of § 72 with an allowance for recovery of basis. Rev. Rul. 239, 1953 CB 53; Rev. Rul. 5-119, 1955-1, CB 352.

The federal law does exempt death proceeds from life insurance but, like Massachusetts, it does not extend the exemption to sums received as death benefits from annuity contracts. Rev. Rul. 239, 1953-2 CB 55; Rev. Rul. 55-119, 1955-1 CB 352.

COMPARISON WITH TAXATION OF ANNUITIES IN OTHER STATES

While there is no true uniformity among the states, two-thirds of which do have a personal income tax, not one follows the annuity tax design of Massachusetts. Sixteen states have no income tax, and two, Tennessee and New Hampshire, have a limited income tax. There is no state income tax in Pennsylvania or Ohio, but various cities in these states levy a tax on business income.

As to the taxation of annuities, the states generally follow one of these three patterns:

1. One-half the states exempt all annuity payments until the cost is recovered. Thereafter, the whole amount is considered taxable income.
2. The federal rule of the 1954 Code is followed in approximately 25% of the states.
3. Eight states use the old 3% rule of the 1939 Internal Revenue Code.

Only New Mexico exempts all annuity income.

For insurance proceeds, a majority of the states use a cost recovery rule for endowments or cash surrender proceeds, whether paid in a lump sum or in installments. The remainder of the states follow the annuity rule of the federal statute. In most states

amounts received at an insured's death are subject to neither an income nor an inheritance tax, irrespective of the option selected by the beneficiary. However, if the money is left with the company and interest is paid, many jurisdictions include such interest in taxable income, as do Massachusetts and the federal government.

In the field of employee benefits and pensions, there seems to be a growing trend among state legislatures to adopt the federal rule as to both estate and income tax treatment. CCH State Tax Guide, § 15.205-15.942; Research & Rev. Serv. Vol. 3, pp. 19.147-19.152.

CONCLUSION — FUTURE TREND OF THE ANNUITY TAX IN MASSACHUSETTS

While there are inconsistent patterns of annuity taxation under both federal and state statutes, nowhere is the departure from basic tax and economic theory as great as in Massachusetts. From this survey of Massachusetts' singular position on annuity taxation, it would seem that either more clarification, or a complete rewriting, of the annuity section is long over due. This much needed revision can be initiated by the Commissioner, by the courts, or by the legislature. To date little has been done!

The Commissioner was given broad powers of interpretation by the original 1916 income tax law. G. L. c. 62, § 38. His authority to issue regulations has never been exercised to its fullest extent. Even the regulations that were made were not always followed as to questions or substantive law. Then in 1941 all regulations were rescinded. For over ten years the taxpayers had no alternative (except litigation, too costly relatively to be practical) but to follow the unwritten policies and opinions of the Commissioner and the Income Tax Division. In 1953 the General Court again authorized the issuance of regulations. 1953 Mass. Acts, Ch. 654; G. L. c. 14, § 4. But as of 1961 there are still sections which have not been clarified by regulations or rulings. Annuity regulations were adopted in 1959, but these merely restated prior court decisions and did little to relieve the doubtful areas or to clearly define annuity income.

The courts also have shown a reluctance to initiate any changes in the property concept of the annuity tax or to establish a more equitable basis for annuity income tax liability. In fact, some of the decisions have only added to the complexity of the law. An example is the treatment of life insurance death proceeds paid in installments. Under present case law a beneficiary, age 65, with a life expectancy of less than 20 years, must report as income each installment of the insurance money paid over his lifetime, whereas

if the beneficiary elected to receive the proceeds for a period of 20 years, there would be no tax, although the same total amount would eventually be received.

While the courts and the Income Tax Commission can do much to renovate the nineteenth century concepts of the Massachusetts income tax laws, in the final analysis it is the General Court which must establish a more consistent, equitable and modern basis for the income tax on annuities. It is the lawmakers who have the responsibility to regularly and systematically adjust the tax statutes to changing economic conditions. Only the legislators can thoroughly untangle the web of confusion that has resulted from Massachusetts' clinging to the theory that the income tax is a property tax designed to reach tangibles and intangibles not subject to a general property tax.

To assure a lasting remedy of the present tax inequalities and inconsistencies, especially in the taxation of annuities and insurance proceeds, cooperation and assistance also should come from the courts, the Commission and the taxpayers themselves. Clarification of current case law and the establishment of a fair tax basis will not result merely from adoption of the proposed graduate income tax law if present rules carry over in part to a new law. During the 1960's Massachusetts should review and modernize its entire tax structure. A starting point would be to initiate a thorough study of the taxation of annuity income.

By recognizing the increasing importance of annuity income for retired individuals and the related investment capital it offers, Massachusetts could formulate a model annuity tax which would incorporate features of the federal law as well as those of other states. Such a statute should clearly define annuity income, allow for recovery of the capital investment, and promote annuity savings by favorable tax treatment or exemption of such income received by taxpayers over age 65. Instead of standing alone, Massachusetts could lead the way in annuity taxation as it has done so well in other judicial fields.

Public Criticism of Judicial Decisions

By HON. PAUL C. REARDON

The following is a statement issued on October 23, 1961, by Judge Reardon, in his capacity as Chief Justice of the Massachusetts Superior Court. The editors are pleased to print the statement in full because many Massachusetts newspapers, which had devoted considerable space to critical comments by certain individuals, saw fit then to print only brief excerpts from the statement issued by the Chief Justice.

An established sitting for the disposition of criminal business in Hampden County was held in Springfield commencing on September 11, 1961 and was presided over by Edward J. DeSaulnier, Jr., a Justice of the Superior Court. On September 21, 1961 there were presented to the Court the cases of Joseph Rossi and Joseph B. Lefebvre, both having pleaded guilty to certain indictments returned by the Grand Jury for Hampden County, and the Court thereupon made a disposition of the matters. Following upon their disposition there was extensive adverse press comment, and there arrived at the office of the Chief Justice of the Superior Court in Boston twenty signed letters protesting the disposition and a not unsubstantial number of anonymous communications to the same effect. Eight individuals had signed one of the letters of protest. In addition, there were referred from the office of the Governor copies of two additional communications to him, one of which was signed by nineteen individuals and which contained the following paragraph:

> "We feel that this is definitely a miscarriage of justice and that the taxpayers of Hampden County should receive some sort of an explanation from Judge DeSaulnier or else he should be investigated for malfeasance of office. Those of us who know more about retailing than we do about law are perfectly willing to start a petition for the recall of Judge DeSaulnier."

Several additional signed letters in support of the Judge were also received.

On September 28, 1961 there was issued from my office a statement indicating that full consideration would be given to the complaints received.

The expression of grievance as to judicial action in individual matters disposed of by the Justices of the Superior Court is not

novel in its long history. This is not the first instance of complaint either in that history or in my tenure as Chief Justice. The nature of the judicial process being what it is, it presumably will not be the last. Hence, it is of prime importance that there be public understanding of the powers of the Chief Justice upon the lodging with him of such a complaint.

General Laws Chapter 212, Section 2, is that statute which governs the action which the Chief Justice may or may not take, given certain circumstances. It reads as follows:

> "The court shall be held by one of the justices, and when so held shall have and exercise all the power and jurisdiction committed to said court. The chief justice shall make such assignments for the attendance of a justice at the several times and places appointed for holding the court as will be most convenient and as will insure the prompt performance of its duties."

In other words, a judge holds court by assignment of the Chief Justice but is the sole arbiter of any specific matter heard before him. A Judge of the Court, having been assigned to his sitting, is vested with all power in dealing with the matters heard at such sitting be they civil or criminal. If he errs on occasion in dealing with law or fact, there is corrective action available through appropriate established channels.

If, on the other hand, he be improperly motivated the Chief Justice may relieve him of the assignment in the public interest, pending that further action provided for in the Constitution of the Commonwealth. In the disposition of criminal cases the proper exercise of judicial discretion is of great importance but the importance of judicial motivation in such dispositons is supreme.

In the light of these considerations and limitations, I have conducted an exhaustive inquiry into the disposition complained of and have, at a series of meetings in inquiry, recorded the statements of every individual who was present in the courtroom at the time of said disposition and who participated therein in an official capacity. I have proceeded along certain other avenues of investigation also into fields which appear to be linked with the incident, and I find the facts to be as follows.

On July 30, 1961 the defendants Rossi and Lefebvre broke and entered, in the nighttime, premises occupied by one Leo J. Simard, a jeweler, located in a building at 54 Suffolk Street in the City of Holyoke and, while engaged in burglary, were apprehended

there by the Holyoke police. As a result of further effective police work, the defendant Rossi was identified as the individual who broke into the store occupied by Bishop's Jewelers at 280 High Street in Holyoke on the night of July 8, 1961. In the Bishop break, jewelry to the value of $8,000 was taken, none of which has been recovered. In the Simard break, there was approximately $25,000 worth of jewelry involved but there was no loss thereof. Following complaints against the defendants in the District Court of Holyoke and hearings thereon, they were bound over to the next sitting in Hampden County of the Superior Court for the transaction of criminal business and were thereafter confined in the Hampden County jail. In due course the Grand Jury for Hampden County, at its September sitting, returned five indictments, three of which were against Rossi—two for breaking and entering in the nighttime with intent to commit larceny, and one for knowingly having burglarious tools in his possession—and two of which were against Lefebvre—one for breaking and entering in the nighttime with intent to commit larceny, and one for knowingly having burglarious tools in his possession. To each of these indictments the defendants pleaded "Not Guilty" upon arraignment on September 18, 1961.

Within several days, the District Attorney, having been in formed by counsel that the defendants wished to retract their pleas and plead guilty to each indictment, the defendants were brought into court, at which time each of them did retract his plea, and they then severally pleaded "Guilty" to each indictment.

The disposition of the matters took place in open court. Present in the courtroom in an official capacity at the time of the dispositions, in addition to the Presiding Judge and the Court Officers, were the Assistant Clerk, Edward J. McKay, the District Attorney, Matthew J. Ryan, Jr., the defense counsel, Daniel M. Keyes, Jr. and Robert J. Bevilacqua, and the Probation Officer, Jeremiah M. Finn. Also in attendance was Paul E. Philbin, the Court Stenographer. A series of eight meetings held by me with the principal participants in the courtroom at the time of the dispositions has developed essential unanimity in the description of what took place.

Prior to the hearing itself and upon notice that the defendants wished to change their pleas, the cases were brought on in the regular course of business, there having been no conferences relative thereto either between counsel or by either or both counsel with the Court. Upon the change in the pleas in open court, the

District Attorney proceeded to outline to the Court the facts relative to each indictment, a resume which consumed some ten or fifteen minutes. Defense counsel Keyes then made a statement of equal length in which he emphasized that while these were matters of breaking and entering in which efficient police work had caught the defendants in the act in the second burglary, there were no dangerous weapons involved and no violence done or intended. With regard to Rossi, he pointed out that he was a married man with two children, owning his own home in Providence, and that a "long probationary term" for him would serve as a greater deterrent in this instance, particularly where Rossi was wanted for burglary in Hyannis and also in Providence. He emphasized that Rossi would remain in custody and that there was a warrant for him at the moment in court. As to Lefebvre, he emphasized the broken home from which he had come, his father having died when he was very young, and his lack of any parental guidance throughout his early years. The memories of the participants are somewhat at variance as to whether any statement was made that both defendants were wanted in Rhode Island but the District Attorney is under the impression that such was represented to the Court, and the Court definitely received the impression that warrants were waiting for both defendants. At the conclusion of the arguments of defense counsel, the Court inquired of the District Attorney whether he had any recommendations relative to disposition and the District Attorney stated, "The records of these fellows speak for themselves. Parenthetically it may be stated that the District Attorney had, during the sitting, sometimes made recommendations on disposition and sometimes not. In this instance he stated that notwithstanding the fact that he made no recommendations he intended to emphasize the records of the defendants by making the above statement with sufficient force to negative the effect of what defense counsel had argued to the Court. The question of restitution as to the goods stolen from Bishop's Jewelers, which sustained the only loss, was not raised. The criminal records of the two defendants were presented to the Court by the Probation Officer. They disclosed that Rossi had served time in correctional institutions in Rhode Island on two occasions, and that as to four other charges at various times back to 1954 against him in Rhode Island the matters were marked "No disposition." Lefebvre had been imprisoned on one occasion in Rhode Island, and as to three other charges made against him, the earliest being 1957, all in Rhode Island, there was "No disposition."

By letter dated August 14, 1961 the Chief Probation Officer of Hampden County wrote to the Assistant Director of the State Prison in Rhode Island for information on these two defendants, stating that they would appear before the Court at the next criminal sitting in Hampden County the following month. On September 5, 1961 he wrote the office of the Administrator of Probation at Providence for information on both defendants, pointing out that they had both served in the Adult Correctional Institution at Howard, and seeking assistance by way of information on them which might be presented to the Court. Prior to the hearing, neither of these letters received any reply and neither letter was returned to the sender. Such information as was presented to the Court by way of a criminal record on these two defendants was transcribed from information received by the Federal Bureau of Investigation through the Hampden County Jail. The Court considered the effect on the pending dispositions of G. L. c. 279, § 1, which in part provides that a sentence may not be suspended in the case of a defendant previously convicted of a felony.

It is to be noted that neither of these defendants had any criminal record in Massachusetts. The Court concluded that as a matter of law G. L. c. 279, § 1, had no application to these defendants. Sentence was then imposed on each indictment to the Massachusetts Correctional Institution at Walpole "for not more than eight or less than six years. Sentence suspended for five years. Placed on probation for five years. A condition of probation the defendant stay out of Massachusetts." All sentences were concurrent.

In addition, the Court commented, following sentence, that since these criminals had come from Rhode Island they could return there and let that state support them in jail, and that if either of them set foot in Massachusetts again within five years, probation would be revoked and they would serve their full term.

The disposition by the Court on the above described indictments, as in the case of any criminal or other finding, decision or disposition by any judge of any Massachusetts court, lies fairly within the realm of free public and press comment. In this instance there are other dispositions, including imprisonment of the defendants for long terms, which were available to the Judge. Having the facts of the crimes in mind, having heard the arguments of counsel, and having reviewed such records of the two defendants as were presented to him, he had the duty to dispose of the matters in the exercise of his discretion and in the light of the circumstances obtaining as he viewed them at the time. It is not suggested that

another disposition could not have been made any more than it is suggested that, all circumstances being considered, this disposition could be labeled as clearly inappropriate. As has been elsewhere stated, "There can be no fixed formula for the determination of wise and appropriate sentences." Before the Judge were two individuals with no records in this state. He was of the belief that with Rhode Island warrants waiting for them, Rhode Island having been the site of the bulk of their lawless activity, the proper forum for treatment lay there. He was also of the belief that the Court was protecting the public of Massachusetts from further depredations at their hands by requiring them for five years to remain outside of this state.

That the Court had before it ample reason for jailing these two defendants is likewise true. What is vital in this matter is that the Court was engaged in the free exercise of that discretion which the statutes confided to his hands. Having exercised it, he was open to the extensive press criticism which followed, as indeed he would have been if his decision were not debatable at all. Judges can expect from time to time to experience the impact of adverse public opinion, even when in their hearts and minds they have endeavored to act with complete propriety in a given set of circumstances. The Superior Court of the Commonwealth last year disposed of 15,276 criminal matters. The dispositions of every single one of these where there were findings, verdicts or pleas of guilty, except in the case of those offenses where there is a mandatory sentence established by statute, might well be open to criticism, for the same set of facts may strike two judges differently and may produce different sentences of varying degree. It was because of the general recognition of this characteristic of the sentencing process that the General Court in the early nineteen-forties established in the Superior Court an Appellate Division with power, on appeal by the defendant sentenced, to lower, to raise, or to leave the sentence imposed by the Judge alone. Judges can and do sometimes err in judgment, and the public also can err and sometimes does in judging the judge. It is certainly not contemplated in the statutory framework which governs the courts that the Chief Justice of the Superior Court be authorized to pass judgment on the wisdom attending every civil and criminal disposition complained of during the course of a court year. On the other hand, were a clear pattern of successive errors to appear or a course of conduct in or out of court which made it apparent in the public interest that a judge be relieved of his assign-

ments, the power to effect that result rests with the Chief Justice. No such state of affairs is evident here.

The District Attorney of Hampden County, in the inquiry held before me, had no fault to find with the general discharge by Judge DeSaulnier of his duties in the public interest during the sitting in which the disposition questioned was made.

In a reply to one individual who had sought the assistance of the Hampden County Bar Association in effecting the removal of Judge DeSaulnier from sitting in Hampden County, the President of the Association, Frederick S. Pillsbury, Esquire, replied in part as follows:

> "Since his appointment to the bench Judge DeSaulnier has presided over six sessions of the Superior Court in Hampden County, including criminal and civil jury and jury waived sessions. During that time he has won the affection and respect of the trial lawyers of this bar who have appeared before him. He has permitted lawyers to try their cases fully and without interference from the bench. While we may not always have agreed with his interpretations of the law, which is what makes lawsuits, no one to my knowledge ever expressed any doubt that his rulings and decisions reflected his honest and considered judgment. Now that one of his decisions has become the subject of criticism, it would seem that he should be afforded the same right to judicial review which is given every other citizen before he is condemned by the people and lawyers whom he serves.
>
> "Freedom of speech and freedom of the press are rights which are guaranteed by our state and federal constitutions. But the real guarantee of those rights is the court system which protects them. If the public faith in the integrity of that system and the judges who administer it is destroyed by irresponsible attacks upon a judge, whoever he may be, we will lose those rights and the dedicated service of our judiciary."

The high desirability of the maintenance of public faith in the integrity of the Massachusetts courts, alluded to in the paragraph above, impels me to some observations. Those are generated in part by the incident which has prompted my inquiry and the publicity surrounding it. They stem in part also from comment by certain individuals on several other recent dispositions unconnected with these.

First, may I say that certain segments of the press, in Hampden County particularly, have repeatedly raised the question of "the

integrity of the Court," and indeed of all Massachusetts courts, in discussing these dispositions. The word "integrity" in its ordinary connotations carries with it the implication of moral strength, uprightness, honesty and freedom from corruptive influence or practice. To impugn a judge directly or by inference on grounds or lack of it is a serious business. To engage in a studied effort to create an atmosphere in which a judge, being publicly assailed on his integrity, is humiliated or embarrassed by news stories linked in no way to the dispositions under fire is also very serious business. It approaches the exceedingly serious when it becomes necessary following such publication for a leading organ of the Massachusetts press to retract on its front page a statement relative to the Judge which it had printed on the front page the day before and which was untrue. If a judge is to be arraigned by a portion of the press before the bar of public opinion on grounds of lack of integrity, he is entitled to know in what respect that integrity is questioned. It is further asserted that there is a positive civic duty, particularly in these days, upon those making such allegations, for whatever reason, to advise whoever may be in charge of the administration of the courts wherein such lack of integrity is charged to exist. The Chief Justice of the Superior Court can take immediate action where there is reasonable doubt as to individual judicial integrity.

It is, therefore, appropriate to re-examine briefly, that the public may understand, the position of the judiciary on these matters with Massachusetts juridical and constitutional history as a backdrop. The Massachusetts Declaration of Rights contains two Articles which are basic constitutional concepts hammered out of the hardships of provincial days and quoted since 1780 as a gospel of democracy in the courts of the United States. They are as follows:

> "Article XI. Remedies, by Recourse to the Law, to be Free, Complete and Prompt. — Every subject of the commonwealth ought to find a certain remedy, by having recourse to the laws, for all injuries or wrongs which he may receive to his person, property, or character. He ought to obtain right and justice freely, and without being obliged to purchase it; completely, and without any denial; promptly, and without delay, conformably to the laws."

> "Article XXIX. Judges of Supreme Judicial Court.—It is essential to the preservation of the rights of every individual, his life, liberty, property, and character, that there be an impartial interpretation of the laws, and administration of justice. It is the right of every citizen to be tried by judges as free,

impartial and independent as the lot of humanity will admit. It is, therefore, not only the best policy, but for the security of the rights of the people, and of every citizen, that the judges of the Supreme Judicial Court should hold their offices as long as they behave themselves well; and that they should have honorable salaries ascertained and established by standing laws."

That all judges should be free and independent was a guiding concept in the Convention which framed the Massachusetts Constitution and, then and there speaking of it, James Bowdoin, President of the Convention and later Governor, said:

> "You will readily conceive it to be necessary for your own safety, that your Judges should hold their offices during good behavior; for Men who hold their places upon so precarious a Tenure as annual or other frequent appointments will never so assiduously apply themselves to study as will be necessary to the filling their places with dignity. Judges should at all Times feel themselves independent and free."

Again and again during the years since 1780 judicial independence in Massachusetts has undergone attack. Attacks upon judicial dispositions have likewise been far from infrequent. The brightest star in Massachusetts judicial history, Chief Justice Lemuel Shaw, was referred to in a New York newspaper following the famous Webster murder trial in the following terms:

> "Out of Massachusetts, and out of a limited circle in it, his judicial character is prostrated, and he will be the first of American judges associated in position and character with the band of cruel and corrupt English judges of whom Jeffries is foremost."

Chief Justice Shaw was not a stranger either to anonymous letters and received, in connection with that case, many heaping abuse upon him.

Oliver Wendell Holmes, former Chief Justice of the Massachusetts Supreme Judicial Court and for nearly thirty years a Justice of the United States Supreme Court, in a 1913 address in reference to occasional attacks on the judiciary said:

> "I get letters, not always anonymous, intimating that we are corrupt. Well, gentlemen, I admit that it makes my heart ache. It is very painful, when one spends all the energies of one's soul in trying to do good work, with no thought but that of solving a problem according to the rules by which one is

> bound, to know that many see sinister motives and would be glad of evidence that one was consciously bad. But we must take such things philosophically and try to see what we can learn from hatred and distrust and whether behind them there may not be some germ of inarticulate truth.
>
> "The attacks upon the Court are merely an expression of the unrest that seems to wonder vaguely whether law and order pay. When the ignorant are taught to doubt they do not know what they safely may believe. And it seems to me that at this time we need education in the obvious more than investigation of the obscure."

At the Constitutional Convention of 1917, John W. McAnarney, an outstanding advocate, spoke on the necessity of judicial freedom in the following terms:

> "Free from what? . . . Free from every motive and influence which might turn them from doing their duty according to their conscience and oath of office."
>
> "How is a man going to be made impartial? . . . We will make you free from all influences but the desire to do right, to render justice. We will put you in a position where you will have no reason for being other than impartial, because your position will be yours so long as you behave yourself, even if that spells the term of your natural life."

But there is a second freedom also and this, in addition to being guaranteed by the first amendment of the Constitution of the United States, is guaranteed by Article XVI of the Declaration of Rights of the Massachusetts Constitution. That Article reads as follows:

> "The liberty of the press is essential to the security of freedom in a state; it ought not, therefore, to be restrained in this commonwealth. The right of free speech shall not be abridged."

The two freedoms thus expressed are not inconsistent each with the other. The judge is free to act and the press is free to comment upon his act. But as the judge is limited in his power to restrain free expression, so the press is vested with a heavy responsibility as a guide to public opinion in maintaining in the public mind, unless otherwise warranted, the integrity of the courts which serve the people. As Mr. Justice Frankfurter said so very well in a concurring opinion in *Pennekamp* v. *Florida,* 328 U. S. 331, 355:

> "A free press is not to be preferred to an independent judiciary, nor an independent judiciary to a free press. Neither has primacy over the other; both are indispensable to a free

society. The freedom of the press in itself presupposes an independent judiciary through which that freedom may, if necessary, be vindicated. And one of the potent means for assuring judges their independence is a free press."

"A free press is vital to a democratic society because its freedom gives it power. Power in a democracy implies responsibility in its exercise. No institution in a democracy, either governmental or private, can have absolute power. Nor can the limits of power which enforce responsibility be finally determined by the limited power itself. . . . In plain English, a freedom carries with it responsibility even for the press; freedom of the press is not a freedom from responsibility for its exercise."

Again, in *Craig* v. *Harney,* 331 U. S. 367, 389 (1946) he stated:

"Comment on what a judge has done—criticism of the judicial process in a particular case after it has exhausted itself—no matter how ill-informed or irresponsible or misrepresentative, is part of the precious right of the free play of opinion."

These considerations should be fully understood by all. There lie the seeds of wisdom which the interest surrounding these dispositions has made available to the bench, the bar, the press and the public alike.

Judicial decisions are open always to criticism. Judicial integrity is not so lightly to be assailed. To permit lack of judicial integrity to exist without just complaint presages common disaster; but to attack it without cause is to strike at the tap roots of democratic government. On the question of integrity, I find no just complaint against Judge DeSaulnier.

The Massachusetts Superior Court has existed in its present form for one hundred and two years, during which time one hundred and sixty-eight Judges have served it. Most of them came from time to time under criticism for individual judicial actions, but not one of them was ever removed from the post held by him because of lack of integrity.

The relief from duty of a judge on every occasion when he is subjected to public ire because of some decision made by him in good faith could lead only to a chaos far from the best interests of those whose plaints were loudest.

The Superior Court has been through these years a free court in the sense that the Fathers of our Commonwealth intended their courts to be. It will continue to be a free court.

Judge DeSaulnier will proceed to carry out the assignments scheduled for him.

Special Session Honoring the Memory of Mr. Justice Abraham E. Pinanski

On September 16, 1961, Reardon, C. J., presiding, a special session of the Superior Court was held honoring the memory of the late Mr. Justice Abraham E. Pinanski. The following is a transcript of the proceedings.

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CHIEF JUSTICE REARDON. All here present will now rise and give attention to the Invocation by Rabbi Maurice L. Zigmond.

(The Invocation was then delivered by Rabbi Zigmond.)

CHIEF JUSTICE REARDON. The Court now recognizes Benjamin A. Trustman, Esquire, of the Norfolk County Bar for an address.

MR. TRUSTMAN. May it please the Court:

We are met here today to honor once again a good man. We are met not in the immediate aftermath of the tragedy of his passing, in a moment torn with grief at our great loss, rather are we met after the lapse of twelve years has given us a perspective against which, in quiet and perceptive reflection, we may reevaluate our early appraisal. And measured against the passage of time, in such framework, we find our early appraisal reaffirmed.

Since most of those present today knew Judge Pinanski so well, I shall take but a moment to sketch a few bare biographical facts:

He was born in East Boston on July 9, 1887, the son of Nathan Pinanski, a pioneer leader of the Boston Jewish Community.

In 1904, he was graduated from Boston English High School. At Harvard College, he completed his work in three years, graduated with the class of 1908.

In 1910, he was graduated from the Harvard Law School. He joined the legal department of the Boston Elevated Railway Company where, as an assistant general counsel, he acquired substantial trial experience.

In 1913, he established a law firm with George E. Morris, Esquire.

During World War I he was a captain in the ordnance department of the Army, and, after his discharge, he was counsel to, and a member of, the Boston District Claims Board of the War Department.

In 1921, he formed the new law firm of McConnell, Pinanski and Morris. He spent most of his time in the trial of cases, and was elevated to the Superior Court Bench by Governor Frank G. Allen on January 29, 1930. In his nineteen years as an associate justice of The Superior Court he sat on many important cases. He died on October 5, 1949, at the age of sixty-two, after an illness of several weeks.

I knew Judge Pinanski for the last twenty-five years of his life. Not as long, perhaps, as many here present, but as intimately—perhaps more intimately than most who were not members of his family. I knew him throughout his prime when he was approaching the full flowering of his tragically shortened life. He was fifteen years older than I—a period short enough to permit substantial intimacy but long enough to make him a senior entitled to, and receiving, the admiration, respect and affection of a grateful junior to whom he taught much.

I worked with Judge Pinanski, talked and walked with him on countless occasions over the years. I think I came to know him as he truly was—a fine lawyer, an outstanding judge and a tireless, almost avid, worker for his fellow men and for his community, an exemplary human being in the finest conception of man's role on earth. This was no accident. He had inherited from his parents a predisposition to philanthropy and good works.

He talked constantly of public service and its importance to the character of the server. This was religion with him, and he practiced what he preached.

Time will not permit a listing of all his affiliations, but a few of the most important must be mentioned in order to have some appreciation and reminder of the distinction of the offices he held and his position in the general community:

He was a vice-president of the Associated Jewish Philanthropies and had been a director of the Federated Jewish Charities which preceded it.

He was vice-president and Chairman of the Executive Committee of the Beth Israel Hospital; President of the Jewish Child Welfare Society; President of the Hebrew Free Loan Society (which his

father founded); President of the Board of Trustees of the Boston Public Library; Trustee of the Peter Bent Brigham Hospital, and of Boston University; of Temple Israel, and of Congregation Adath Jeshurun.

He was a member of the Executive Committee and a co-founder of the Massachusetts Committee of Catholics, Protestants and Jews; a member of the Board of Managers, and Chairman of the Appointment Committee of the Boston Dispensary.

He was a member of the Councils of the Boston Bar Association, Massachusetts Bar Association, and Harvard Law School Association.

I have never met anyone more busily occupied in the interest of his community and his fellow man or with such an intense fervor and restless zeal. He gave unstintingly of himself; his sincerity, loyalty and devotion were never less than whole. We could never understand how he found the time to attend all the meetings of all these organizations.

I will remember him running to a meeting at court recess at one, running back to court at two, and to another meeting on the same day at four, and perhaps another at eight.

He was a man of driving and tenacious energy, and a passionate advocate of all causes he espoused. Gifted with an active, fertile mind and a talent for oral and written articulation, he conveyed to others his own tremendous enthusiasm and dynamism. He combined rare qualities of heart and mind and spirit. He joined leadership in his chosen profession with a deep sense of community responsibility.

To the law and to the bench, and to his many public and philanthropic affiliations, he brought to bear a penetrating intellect, enthusiasm, energy and vitality until illness struck him.

There was nothing taciturn, reserved or shy about Judge Pinanski, he was an extrovert who loved not merely doing things for his fellow man but with his fellow man. He loved people. He had a certain magnetism which caused others to follow his lead. He was a gracious and charming companion. Though intensely serious and tightly wired, he had at the same time a delightful sense of humor, and constantly admonished others to maintain a sense of proportion and not to take themselves too seriously.

He had a refined sense of values and of the fitness of things, and to him only the ethical and honorable way was the correct way. He abhorred pomposity and false pride and pretense.

As a lawyer and judge, he was a stickler for detail. He probed

into obscure recesses of the law. He had an intellectual curiousity and was facinated with new problems and new solutions.

From his years as a trier of cases and his experience as a judge, he became keenly interested in medico-legal problems, and wrote and lectured much to improve legal and judicial practices.

He was a co-founder of our pre-trial procedures. He was in the forefront of the constant battle against judicial delays. He was a wise counselor, and on the bench he was blessed with a calm, equable and considerate temperament.

His warmth and generous spirit communicated themselves to other members of the bar, his colleagues on the bench, witnesses and jurors in the courtroom, and co-workers in his philanthropic causes. He earned the affection and respect of all who had contact with him.

He had a strong sense of family loyalty and was devoted to his dear wife, daughters, sisters and brother.

Too often notoriety outlives fame; too often do we remember our worst citizens longer than our best ones. It is right that we should have this occasion to think again of this good and kind man and of his contributions to this community, and our great debt to him. To borrow a phrase, "He was the very model of a lawyer, judge, citizen, husband and father." He made emulation difficult. He lived a rich and useful life, pathetically cut too short. His public service will be his monument.

We may perhaps find some comfort in a passage from Longfellow:

> "There is no death! What seems so is transition;
> This life of mortal breath
> Is but a suburb of the life Elysian
> Whose portal we call death."

I should like to believe that Judge Pinanski is still serving with his energy and enthusiasm in the hereafter.

CHIEF JUSTICE REARDON. The Court will now recognize Daniel G. Rollins, Esquire, President of the Norfolk County Bar Association for an address.

MR. ROLLINS. May it please the Court, I represent at this Special Session the Bar Association of Norfolk County. It is fitting that we should participate in this presentation of a memorial to a great judge.

On behalf, therefore, of my clients I state to this Court the appreciation of the Bar Association of Norfolk County for what is being done on this occasion.

My learned brother who preceded me has expressed his hope that Judge Pinanski is still serving with energy and enthusiasm in the hereafter. I suggest to this Court that he is serving here and now.

A legacy has been left to us, the younger members of the bar, and to all lawyers of the Commonwealth, and we must decide its disposition with integrity, honor, ability, humor, strength, knowledge, a desire for truth—all these attributes of Judge Pinanski.

We must, it seems to me, communicate to those who follow us these fundamentals. In this way there is, and there will be, immortality.

I would like to add one other thought:

I speak from personal knowledge, both of the Judge and of his dear wife, and I want to say that his dear wife, no doubt inspired by this just and good man, has gone forward with charitable works in which he was connected.

I am sure that his appreciation of her is equal to that of her for him.

Chief Justice Reardon. For the purpose of the presentation of a Resolution, the Court now recognizes one whose esteemed father and Judge Pinanski were comrades in the law over a long period of time—Samuel P. Sears, Esquire, representing the Massachusetts Bar Association.

Mr. Sears. May it please the Court, I should like to read a resolution that was passed by the Board of Delegates and the Executive Committee of the Massachusetts Bar Association last week-end:

RESOLVED, that the Board of Delegates of the Massachusetts Bar Association, most of whose members knew the late Mr. Justice Abraham E. Pinanski as a respected lawyer, a fine judge and a good citizen, join with his family, his friends and associates in a memorial in his honor to be held on Saturday, September 16, 1961, at the Norfolk County Court House in Dedham; and, that a special committee of the Massachusetts Bar Association, comprised of the officers and past presidents, be appointed to represent the Association at such memorial services, and, on his behalf, to express the gratitude of the lawyers of Massachusetts and the community in general for the many notable contributions Judge Pinanski made for the more effective and efficient administration of justice during his 19 years on the bench, and to reaffirm, even after the span of 12 years since his passing, the high regard and deep affection in which he continues to be held by the Bar and the citizenry of the Commonwealth;

RESOLVE FURTHER, that a copy of this Resolution be sent

to Viola Pinanski, widow of Judge Pinanski, with the warm wishes and cordial felicitations of the Massachusetts Bar Association.

I hope it's not inappropriate for me to add that it's particularly pleasing for me to have an opportunity to read this Resolution, because I tried the first jury case before Judge Pinanski in this very court room.

CHIEF JUSTICE REARDON. The Court now respectfully turns to a distinguished son of Norfolk County, thrice welcome here, once again at home, who served as a valued colleague for years on the Superior Court with Judge Pinanski, and who is thus most qualified to speak in his memory, the Honorable Harold P. Williams, Associate Justice of the Supreme Judicial Court of the Commonwealth.

MR. JUSTICE WILLIAMS. This gathering of former friends and associates of Abraham Pinanski after so many years is an impressive indication of the universal and enduring respect and esteem with which he was regarded. Time takes its toll and only five of us, including, incidentally, Chief Justice Qua, who were on the Superior Court when Judge Pinanski was appointed are now alive, although some twenty judges remain who have served as his colleagues.

When he was appointed to the bench in 1930, he had established an enviable reputation at the bar as an advocate. While a sound advisor in commercial matters, his best loved vocation was the trial of cases in the courts.

He had a natural aptitude for apprehending and marshalling facts which, through training and experience, was supplemented by a comprehensive knowledge of the applicable law.

The possession of these capacities made attorney Pinanski a strong and resourceful advocate at the bar and Judge Pinanski an able and accurate judge on the bench. His rulings were to an unusual degree unexceptionable as may be gathered from the relatively few appeals from his findings and rulings which are recorded in the law reports.

He had an instinctive sense, fostered by experience, of the value of cases. The bar speedily came to appreciate this quality, and by virtue of their confidence in his honesty and fairness he was enabled to adjust satisfactorily much litigation without the expenditure of time and effort spent in trial. His ability to effect the amicable settlement of litigation made him peculiarly valuable in the work of pre-trial sessions.

Mention should be made of his administrative ability:

He served for years on the committee of the court which dealt with problems incident to probation and the probation department.

He was a member of the court's house committee, and no social or other gathering of the judges was ever undertaken except under the guiding hand of Judge Pinanski. Mr. Trustman has referred to his many extra judicial activities.

He was a kindly man, loving his fellowmen, and, because of that love, he enjoyed to the full judicial work which required the helpful adjudication of controversies in which they were prone to be involved. In the exercise of his judicial functions, he was the embodiment of those qualities which we like to think are the characteristics of the ideal judge: courteous consideration of testimony and the arguments of litigants; ability to find and declare the true facts; and when determined, the wisdom to render the rightful judgment.

With his portrait before us in this familiar courtroom where he so often presided, Judge Pinanski seems almost to be present, an alive and gracious figure. In him we remember a loyal friend, a charming companion, a man of high ideals, and a strong judge.

We welcome this opportunity to honor his memory.

CHIEF JUSTICE REARDON. As Chief Justice of the Superior Court, and in its behalf, I accept the gift here tendered of a portrait of Abraham Edward Pinanski who graced our bench for nineteen years.

Although time has passed along so swiftly since his death, who could forget this wise and kindly judge, learned and alert, and yet withal possessed of that fine spirit of humor and compassion which so often resolved the seeming impasse.

Mr. Justice Williams has remembered and spoken of him as a colleague. I recall him as the sympathetic auditor and guide in the efforts of a fledgling lawyer in the pre-trial sessions in Suffolk years ago. All here present will be glad that through the means of this portrait there is made available to our bench and bar alike a reminder of a man with a character most worthy of remembering, who made in life great contributions to Massachusetts justice and whose influence, now that he is gone, abides with us.

Mr. Clerk, these proceedings are ordered spread upon the records of this Court, and this Special Session stands adjourned.

(The Special Session adjourned at 11:30 a.m., September 16, 1961.)

The Impact of the Small Business Investment Act of 1958 on Small Business Financing in New England

PHIL DAVID FINE *and* GERALD S. FISHER

The authors are both members of the Massachusetts bar. Mr. Fine, who is Deputy Administrator of the Small Business Administration in Washington, D. C., is senior partner (on leave) of the law firm of Fine and Ambrogne in Boston. Mr. Fisher is a graduate of Boston University Law School, and is presently serving as Chief, Regulations and Compliance Branch, Legal Investment Division, Office of General Counsel, Small Business Administration.

Introduction

Small business is generally pictured as the poor relation of American free enterprise even though a primary source for our unparalleled industrial growth has been the boundless energy of individual entrepeneurs. The more than four million small businesses play a unique and vital role in our daily lives by supplying myriads of goods and services in our economy and by constituting an indispensible breeding ground for new products, better services, and technological innovations. Despite their number, small businesses, and our economy, are dominated by big businesses which enjoy the lion's share in many industries, resulting in perennial financial problems for the small businessman.

While small business may be overshadowed, they are not overlooked. Congress has shown a great deal of interest and sympathy for the small businessman, especially for his financial plight. Thus, in the years 1950 and 1958 there was introduced into legislation some proposal or other for a capital banking structure designed to supply equity and loan capital to small business. At the request of Congress, the Federal Reserve System, in the latter half of 1957, undertook a multipronged nation-wide study of the financing facilities available to small business. Part of that study resulted in the Federal Reserve Report dated April 11, 1958, to the Committees on Banking and Currency and the Select Committees on Small Business, U. S. Congress, entitled "Financing Small Business," which pointed out that there was no institutional source to which the small businessman could turn for sufficient long-term and equity capital to expand a business. Hearings in the 85th Congress, 2d Session (1958)

on this problem brought out that equity capital and long-term financing for the operations, growth, expansion, and modernization of small businesses generally were unavailable. Commercial banks furnish short-term or intermediate-term loans; the cost of public sale of securities is disproportionately high for small business concerns, even if marketable; and the Small Business Administration provides intermediate-term loans under its regular lending program but cannot provide the necessary equity capital or long-term loans. This lack of sources for such funds has often been called the "institutional gap."

A New Institution Is Born

A number of legislative proposals were pending in Congress in 1958 to make such funds available. Some proposals would have created a national investment company in each State, others would have created small business capital banks in each Federal Reserve District, while still others would have broadened the powers of the Small Business Administration. What may be called a compromise approach was adopted whereby privately owned and operated, and to a large extent privately financed investment companies, were chosen as the vehicle to provide the missing financing. The resulting legislation, signed by the President on August 21, 1958, was entitled "The Small Business Investment Act of 1958" (15 U.S.C. §§ 661-696) (hereafter called the "Act"). The declared policy of Congress, as stated in the Act, in adopting this legislation is the enhancement and stimulation of the national economy in general and the small business segment thereof in particular by programs designated to stimulate and supplement, not supplant, the flow of private equity capital and long-term funds which small businesses need for the sound financing of their business operations and for their growth, expansion, and modernization. Two programs are set forth under the Act; Title III thereof deals with small business investment companies while Title V authorizes Small Business Administration loans to State and local development companies to be employed for the benefit of small business concerns. This article will cover the impact of both programs in the New England States.

Development and Operation of the Small Business Investment Companies Program

Under Title III of the Act, the Small Business Administration is authorized to license private corporations chartered under State law expressly for the purpose of providing equity capital and long-term

loan funds to small business concerns. In addition, the Small Business Administration is empowered to provide small business investment companies with financial aid in their establishment and with operating loans for their operations. Title III also requires the Small Business Administration to regulate and examine such companies to insure that they are operating as contemplated by the Act.

As pointed out above, the Act requires licensees to be chartered expressly for the purpose of operating under the Act. Thus, under the Act the Small Business Administration must be sure that a proposed licensee will be empowered to conduct only the activities contemplated by the Act, i.e., the purchase of equity securities and the making of long-term loans to small businesses, with concurrent authority to provide consulting and advisory services on a fee basis for such concerns. To this end, the Small Business Administration must approve the articles of incorporation of a licensee and, further, must consider the need for such financing in the proposed area of operation, the general character of the proposed management of the licensee, and the number and volume of business of licensed companies in the area of operation in making a decision as to whether or not to license a given applicant.

Pursuant to the Act, regulations (13 C.F.R., Part 107) have been adopted which set forth how a license may be obtained. The preliminary application must set forth the plans of raising the initial capital, the proposed operating area, the need for such a licensee therein, copies of the proposed articles of incorporation and bylaws, plan of operation, investment policies, and qualifications of proposed management. If this preliminary application meets all the standards required by the Act, the applicants are notified to file the license application itself, which calls for certain exhibits as to proper formation and capitalization and which constitutes the offer by the company to carry on the activities called for by the Act in accordance with the provisions of the Act and the regulations issued thereunder.

Inducements

Upon licensing by the Small Business Administration, the licensed small business investment companies are eligible for financial assistance from the Small Business Administration and statutory and discretionary exemptions under the Securities Act of 1933 (15 U.S.C. §§ 77a-aa), the Trust Indenture Act of 1939 (15 U.S.C. §§ 77aaa-bbbb), and the Investment Company Act of 1940 (15 U.S.C. §§ 80a-1 to 52). In addition, a licensee and its shareholders are eligible for tax benefits specified under the Technical Amend-

ments Act of 1958, as amended in 1959 (72 Stat. 1606, 73 Stat. 699, 700). Briefly summarized, these tax benefits are (1) an active small business investment company, operating under the Act, will not be subject to the accumulated earnings tax, (2) except under certain circumstances, it also will be exempt from the personal holding company taxes, (3) it will get an ordinary loss treatment when a loan goes bad, (4) it will be entitled to operating loss carry-overs on its investment losses, and (5) a 100 per cent credit for dividends received from small business concerns is allowed rather than the normal 85 per cent reduction. The shareholders of a licensed small business investment company also get a tax break, for if the shares gain in value, the stockholders, when they sell, are taxed by the capital gains method; if they lose on the sale of such stock, or through worthlessness, such losses may be treated as an ordinary loss rather than a capital loss. This loss deduction applies to all purchasers of stock of a licensee and not just to the original shareholders. As a benefit to both the company and its shareholders, a licensee may, under certain circumstances, qualify as a "regulated investment company" under the Internal Revenue Code whereby substantial corporate level taxes are eliminated and capital gains may be "passed through" to the shareholders without tax to the licensee.

Subsequent Legislation

The small business investment company program generally is recognized as a novel approach to a perennial problem and, as such, it was bound to have growing pains which called for legislative surgery. Thus, section 304 of the Act as originally passed provided that equity capital could be provided only by the purchase of convertible debentures. This restriction was said to hamper the investment opportunities of licensees who desired flexibility in their equity investments. As a result the Act was amended in 1960 by the Small Business Investment Act Amendments of 1960 (Public Law 86-502) to provide that a licensee may provide equity capital to small business concerns in such manner and under such terms as the licensee may fix in accordance with regulations prescribed by the Small Business Administration. Technical changes also were made.

In the hearings on the above amendments to the Act, held in March, 1960, other ills in the program were pointed out to Congress. Thus, it was stated that the minimum $300,000 capitalization was insufficient, that the "leverage" of four-to-one debt ratio was unob-

tainable, and that operating loans to licenees by the Small Business Administration should be increased.

Hearings before subcommittees of the Senate and House Banking and Currency Committees were held in August, 1961 on S. 902 and H. R. 6672, both designed to further amend the Act. The resulting legislation (Public Law 87-341) was signed by the President on October 3, 1961. This authorized the Small Business Administration to match private funds for use as capital and surplus up to $400,000; set a limit of $4 million on Small Business Administration operating loans to licensees; allowed banks to invest 2 per cent of their capital and surplus in licensees; imposed a $500,000 limitation of investment in any one concern by a single licensee; and lastly, gave the Small Business Administration the power to suspend licenses, issue cease and desist orders and conduct investigations.

Financial Statistics on the Program

With the foregoing as background material, it is appropriate to review the available statistical information on this program. As of October 31, 1961, the Small Business Administration had received 774 proposals (preliminary applications) for licenses, involving a total initial capital of $289,743,288, only $99.2 million of which represented requests for government funds under section 302 (a) of the Act. These figures must be reduced by $35.2 million and $7.1 million, respectively, to reflect the termination or withdrawal of 65 proposals, leaving a net figure of 709 proposals received.

As of the same date, a total of 407 small business investment companies were licensed and operating representing a total initial capital of about $145.6 million, of which about $50 million represented Small Business Administration commitments. However, this does not reveal the true picture as to the amount of funds currently available in the program. Thirty-nine licensed small business investment companies have sold their shares in offerings to the public for a total net proceeds to such licensees of approximately $250 million, making the total capital currently available for investments about $395.6 million. In addition there are 18 more licensees that have filed registration statements seeking to offer approximately $77 million (net estimated proceeds to the issuers) of securities to the public.

The remaining 302 proposals are in various stages of review by the Washington office of the Small Business Administration. Of these 143 have received their notice to proceed to file the final license application, which is tantamount to licensing; 123 were

under initial review and 36 license applications were under review. Assuming all these become licensed, the capital available in the program will be increased to an impressive $581.4 million without taking into consideration the amount of capital these proposed licensees may raise from public offerings.

Small Business Investment Companies in New England

The story of small business investment companies in the New England States is an enigma. As a whole, these six States do not have a representative portion of small business companies. Yet, on the other hand, the two largest licensees are incorporated in the Commonwealth of Massachusetts. Broken down by States, we find that Connecticut has 13 companies incorporated and licensed to do business in that State with a total capitalization of about $5 million of which approximately $1.9 million represents Small Business Administration funds purchased pursuant to section 302 (a) of the Act. Massachusetts has 17 companies incorporated and licensed to do business therein with a total capitalization of about $59.3 million, of which about $1.8 million represents section 302 (a) funds. The State of Rhode Island has 2 such companies, with a total capitalization of about $6 million, only $150,000 of which represents government funds. The state of New Hampshire has one licensee incorporated therein while none are incorporated in the States of Maine and Vermont. However, of the above-mentioned licensees in Massachusetts, 4 are licensed to operate in New Hampshire, 2 in Maine, 3 in Vermont, 4 in Connecticut, and 4 in Rhode Island. In addition to the foregoing, there are 22 proposals from the New England states with a total proposed initial capitalization of $16.6 million, of which $2.4 million represents government funds. Twelve are from Massachusetts, 8 from Connecticut, and 1 each from the States of New Hampshire and Rhode Island. If licensed in their requested areas of operation, Massachusetts would have 14 more small business investment companies licensed to do business there, Connecticut 16, Rhode Island 8, Maine 5, Vermont 4, and New Hampshire 7.

The above-mentioned licensed companies have made approximately 400 financial investments in New England small businesses for a total outlay of about $20 million. This financial infusion of funds is almost equally divided between equity securities and long-term loans. Investments have been made in almost every known industry and business, with building construction, lodging places, eating places, automotive dealers and gasoline stations, electrical

machinery, retail food stores, and miscellaneous manufacturing and service industries leading the way. In addition to the investments made, a number of licensees have made additional commitments and currently are evaluating potential investments every day. There is no shortage of small businesses seeking funds; the problem is the screening out of the worthy from the unworthy.

The State and Local Development Companies Program

As noted above, the Act contains a second program of financial aid to small business concerns: loans to State and local development companies pursuant to sections 501 and 502 of Title V to the Act (15 U.S.C. §§ 695, 696). Pursuant to section 501, loans may be made to State development companies for the general purpose of helping these companies provide the equity capital and long-term funds to small business concerns needed for their business operations and for their growth, expansion, and modernization. State development corporations may be defined as any corporation organized under or pursuant to a special State legislative act giving it authority to promote and assist the growth and development of small business concerns in such State. This may be part of an overall authority to promote business development throughout the State. Although the corporation may be organized either on a profit or non-profit basis, its primary purpose must be to help business and stimulate the State economy.

A State development company may borrow from the Small Business Administration as much as its total outstanding borrowings from all other sources. However, the Small Business Administration generally reserves the right to limit such loans to an amount which it considers consistent with sound business practice. Section 501 loans may be made for terms up to 20 years, at an interest rate of 5 per cent per annum except that the interest rate may be reduced to 4 per cent if the development company will use the 501 funds for long-term lending to small businesses in areas of substantial unemployment as designated by the United States Department of Labor. As a rule, the maturity of such loans may not extend beyond the maturity of any of the company's other outstanding indebtedness and the rate of repayment must be at no lesser rate than other debts of the State development company. A Small Business Administration loan of this type must be secured, except under certain circumstances, on an equal (ratable) basis with any other funds the development company borrowed after August 21, 1958, the effective date of the Act. For example, if 20 per cent of the company's other bor-

rowings since that date are secured by collateral, then 20 per cent of the 501 loan would have to be secured similarly.

The regulations (13 C.F.R. §§ 108.1-.502-1) require a maximum participation of private financing and to insure participation of private financing sources in the program, the Small Business Administration requires a State development company to supplement 501 loans by one-third; that is, within 30 days after receipt of 501 funds, the development company must have extended to small business concerns, through loans or investments, or both, financing with an outstanding principal value at least one-third greater than the amount of the 501 loan, except that, if the 501 loan funds are to be used for long-term lending to small business concerns in areas of substantial unemployment, the development company need not add any funds of its own to those obtained from the Small Business Administration. This same ratio of outstanding small business financing to balance owed to the Small Business Administration must be maintained during the life of the 501 loan. As another restriction, 501 funds may not be loaned or invested in certain types of businesses as, for example, gambling enterprises of firms which would use such funds for relending or reinvestment. Other funds of the development company may be used in any way the company sees fit.

The second phase of the development company program involves financial aid under section 502 of the Act, to a local development company, which may be defined as a corporation chartered under any applicable State corporation law to operate in a specified area within a State. The area may include a community, an entire county, or under certain circumstances, a larger or different homogeneous area or locality. The local development company must be principally composed of and controlled by local persons or businesses residing or doing business in the locality which the development company serves. The area of operation must be specifically defined and the local persons or businesses must ordinarily constitute not less than 75 per cent of the ownership and control of the development company. No stockholder or member of the development company may own in excess of 25 per cent of the development company if he and his affiliated interests have a direct pecuniary interest in the project involving the section 502 loan or in the small business concern which is to be assisted.

The proceeds of the Small Business Administration loan must be used by the development company only to finance plant construction, conversion or expansion (including the acquisition of land). A 502 loan may be used to augment working capital, or for

debt repayment. One exception to the latter is permitted. The proceeds may be used to pay interim construction financing for an approved project. The loan must be to assist an identifiable small business concern in accomplishing a sound business purpose. A section 502 loan will not be made if either the development company or the small business concern can obtain the necessary financial assistance elsewhere. In addition, before the Small Business Administration can approve a direct loan the development company must show that a private lending institution will not participate with the Small Business Administration in the loan. At least two such institutions must be solicited and the Small Business Administration will require the development company to certify that the needed funds are not available in whole or in part from private lending institutions. No 502 loan may exceed $350,000. However, the Small Business Administration encourages local banks to participate with it in local development company loans and where such participation exists, the amount of the loan may exceed $350,000 by the amount of the bank's participation.

Section 502 loans must be so secured as reasonably to assure repayment. The Small Business Administration will take a first lien position on the project, which must be insured against such hazards and risks as it may require. In projects which are to be occupied by more than one tenant, a separate loan should be applied for to cover the facilities to be occupied by each small business tenant. The collateral in each instance must have a liquidating value at least equal to the amount of the loan, with such liquidating value to be established by a qualified appraiser and accepted by the Small Business Administration. The collateral for each loan may consist of either a separate mortgage on the facility to be occupied by each small business being assisted, or a blanket mortgage on the entire facility, or portion thereof, owned by the local development company. In addition to the mortgage, an assignment of the particular lease and such other collateral will be required as may be necessary to adequately secure the loan.

The Small Business Administration requires the development company to furnish a reasonable part of the funds needed to accomplish the acquisition of land and the plant construction, conversion, or expansion. A development company should be prepared to expend from its own funds at least 20 per cent of the cost of the project, but in any event an amount not less than the excess of the cost of the project over its appraised liquidating value, before any of the proceeds of the 502 loan may be used.

Local development company loans may be for as long as 25 years, plus the time estimated to be required for construction, conversion, or expansion. The interest charge is currently 5½ per cent per annum, except that where a participating bank sets a lower rate on its share of a loan, the Small Business Administration will reduce its rate accordingly, but not below 5 per cent per annum. Furthermore, in areas designated by the Secretary of Labor as having a substantial labor surplus, the interest rate on local development company loans is currently 4 per cent per annum. It should be noted that State development companies may participate in this same manner in the 502 loan program.

Financial Analysis of Development Companies Program

The 501 loan portion of development company program has been slow in its development primarily because a majority of States had no such companies or authorities and also because it was necessary, in most States where State development companies or authorities existed, to amend the enabling legislation to allow such companies or authorities to borrow from the Small Business Administration. As of the date of writing, there appears to be 20 State development companies eligible to participate under this program, 4 States have enabling legislation pending, 6 States are considering proposal for such legislation, 8 States have passed enabling legislation but are not yet active, 10 States have done nothing in this area, and 3 States have such companies but are ineligible to participate in the 501 loan program by virtue of limitations in their charters. The Small Business Administration cannot determine whether or not a State or local development company is eligible to participate under this program until it has examined its articles of incorporation, charter or other source of authority and power.

By far the most active portion of the development company program has been the 502 loans. There are almost 4,000 local development companies in the Nation, and an estimated 3,000 of them are eligible for 502 loans from the Small Business Administration. Further, it is estimated that almost 5,000 chambers of commerce and nearly 400 local tax-supported agencies could form eligible local development companies. However, this tremendous potential has hardly been utilized, for in the 3 years that this program has been in operation, only about 100 local development companies have taken advantage of this program and received Small Business Administration loans.

As of October 31, 1961, 10 State development company loan

applications had been received, 9 of which were approved, for a total of $7,103,750, while 1 for $200,000 was pending. As of the same date, 192 local development company loans had been received in the Washington office of the Small Business Administration requesting a total of $22,924,805. Of this number, 139 loans in the amount of $16,457,231 were approved, $14,788,447 representing the Small Business Administration's portion of 502 loans and $1,668,784 represented bank participations in the program. Fourteen applications for a total of $1,092,275 were declined, generally for lack of adequate collateral; 11 applications for a total of $1,112,950 were withdrawn; 13 applications for a total of $1,952,000 are pending in the regional offices of the Small Business Administration and 15 applications for a total of $1,906,588 were under review in the Washington office of the Small Business Administration.

Title V Loans in New England

The utilization of this program by the New England States has been most discouraging. According to information available to the Small Business Administration, all 6 New England States have State development companies and it is believed that 5 of them are eligible for section 501 loans. Despite this fact, only three 501 loans have been made in this area, all to the Business Development Company of Rhode Island, for a total of $773,750. No such loan applications currently are pending. Massachusetts, which was a pioneer in the State development company field, has the largest and most successful development company but is not eligble to participate in the 501 program because, pursuant to its charter, it is forbidden to borrow from anyone but its organizational members. Consideration currently is being given to amending the enabling legislation to specifically allow it to participate in the Small Business Administration's 501 loan program.

Equally as disappointing, if not more so, is the extent to which the New England States have not participated under the 502 loan program. Only two 502 loan applications have been filed from the New England States, both from the State of New Hampshire. The first loan application involved a request for $28,000 of 502 loan funds by the Derry Industrial Development Corporation for the Jodi Shoe Company, which was granted. The other loan involved $72,000 of 502 loan funds for the Berlin Industrial Realty Company, Inc.

The story of the Derry Industrial Development Corporation 502 loan will help to illustrate how such loans can aid local development

companies increase employment opportunities in their areas and build a stronger, a more diversified economy. In May 1960, a disastrous fire hit the Chelmsford Shoe Company in Derry, putting more than 350 people out of work. Almost immediately a citizens' committee, composed of business and civic leaders, was formed with its objective to create new jobs for the idle shoe workers. Two ex-employees of the Chelmsford Shoe Company offered to launch a new shoe company—if the committee could provide the necessary plant in Derry. The committee found a vacant shoe factory, but the building was badly in need of extensive repairs and it was privately owned. By concerted effort, the committee convinced the owners to turn the building over to the town, which in turn made it available to the development company. The citizens of Derry then contributed about $7,000 towards the $35,000 needed to rehabilitate the plant. The other $28,000 came from the Small Business Administration. The Jodi Shoe Company became a going business, employing about 200 workers, within several months after commencing operations, with an estimated payroll in excess of $500,000.

Conclusion

The Small Business Investment Act of 1958 has been the topic of innumerable law review articles, magazine and trade articles, and newspaper features. The Act has been described by most adjectives in current use, both favorable and unfavorable. The one that I would like to believe as most appropriate is that it is "the most significant piece of legislation dealing with the economically important . . . issue of small business in many a year" as stated on page 3 of "Financial World," September 7, 1960.

The small business investment company program was slow in its germinating period of 1959, the roots started spreading and became more firm in 1960, and the program really took hold in 1961 and came into public favor. Investment groups are applying for licensing in increasing numbers, month after month, and the number of licensees offering their securities to the public investors shows a corresponding increase. This public acceptance of such securities has been a keystone to the growth of the program and represents an outstanding achievement by the industry. This spectacular acceptance of such securities in the comparatively short history of the program is both evidence of public confidence in such companies and a reaffirmation of faith by the investing public in the future of the American economy in general and the small business segment thereof in particular. Much impetus has been given to the program

by the 1960 amendments to the Act, continual review and revision of the regulations under the Act, and by the proposed legislative program. It is hoped that the 1961 amendments also will have such an effect. Whether or not the small business investment company program attains the goal set for it by Congress is a question for the historians and economists to answer. There will be casualties, criticisms, disappointments, and further legislative surgery in attempts to help these companies achieve their purpose. Whatever the final evaluation may be, there is sufficient evidence today that small business investment companies are well on the road to potential success. It is indeed encouraging to see the New England States, pioneers in so many ways of our economy but of late suffering from changes in the economy, seize hold of this new financial institution and use it as a vehicle to foster a rebirth of industry and technology in these States.

The State and local development companies program is an equally important and dynamic approach to the myriad financial problems of small businesses. Nonetheless its utilization and success to date is extremely disappointing. As noted before, there are thousands of eligible development companies throughout the country, but very little interest in this program has been evidenced. To date, the Small Business Administration has made only 135 such loans for a total of $20.4 million. When one stops to realize that a new industry employing 100 people represents such growth factors as 296 more people, 112 more households, 51 more school children, $590,000 more in personal income annually, $270,000 more bank deposits, 107 more cars, 174 more employed workers, 4 more retail establishments, and $360,000 more in retail sales each year, (from "Banking", May 1961, p. 43), it is hard to understand why more communities have not availed themselves of the funds available under this program. The Small Business Administration has made strong efforts to spur economic activity and employment through such companies. It has held meetings to discuss the programs, it has mailed letters to some 5,000 development companies, chambers of commerce, State and local planning organizations, and other groups concerned with economic development in an effort to educate the public. Perhaps these latest efforts will bear fruit.

Unlike the small business investment company program, the development company program has been unsuccessful in New England. Perhaps the fault lies within the communities themselves, i.e., improper attitudes towards new industries, tax structures, zoning, schooling, housing, transportation, or unavailability of manpower, building sites or plant facilities. On the other hand, perhaps the dis-

appointing showing of this program is due to the profit motive as compared to the small business investment company program. To those reading this paper, it can only be urged that you take a second look at your community and ask some frank questions (and answer them honestly) about its progress. If new businesses would be advantageous, initiate the needed steps to mobilize community thinking along these lines. The rewards can be most satisfactory.

Case and Statute

COMMENTS

The following comments were prepared by members of the editorial board. Because of summer recesses, only a relatively minor amount of material has emanated, since our October issue, from the legislature and the Supreme Judicial Court. Included are several noteworthy recent Federal cases which construed Massachusetts law.

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CONSTITUTIONAL LAW—CRIMINAL LAW—TRIAL BY IMPARTIAL JURY.—*Michael V. Geagan, et als.* v. *John A. Gavin,* 292 F. 2d 244 (1961)

The issue raised by the petition for writ of habeas corpus brought by the so-called "Brink's Robbers" is whether they were tried and convicted by an impartial jury within the meaning of the due process provision of the Fourteenth Amendment of the Constitution of the United States. The defendants contended that such massive and sustained publicity surrounded their indictment, arrest and trial, and purportedly emanated from official governmental

sources, that the minds of the jurors were affected with a deep-seated and ineradicable prejudice.

The defendants raised this point at their trial in the Massachusetts Superior Court and in their appeals to the Supreme Judicial Court of Massachusetts, with respect to whose decision certiorari was denied by the Supreme Court of the United States. Having exhausted available state remedies, this petition was brought in the United States District Court. The District Court Judge entered judgment denying the petition and issued a certificate of probable cause for appeal pursuant to Title 28 U.S.C. § 2253.

The Circuit Court of Appeals rendered a decision on the merits upholding the judgment of dismissal, despite the fact that defendants' counsel did not, at the trial, seek court assistance in curbing the continuing publicity nor did they move for a change of venue or a continuance. The Court noted that it is not clear that any court has any practically effective method of preventing "trial by newspaper," and also recognized some basis for counsels' assertion that the publicity was so widespread and continuous that neither a change of venue or a continuance for any reasonable time would have made any difference.

The Court first noted generally that, although the robbery excited widespread interest, because of its skillful and daring execution and the amount of money involved, it was not a crime that aroused general feelings of rage, revulsion or revenge among the general public, nor did it arouse racial or religious prejudices nor involve any political undertones, nor was the trial in any respect mob-dominated.

The Court then went on to make its own independent evaluation of the *voir dire* testimony of the jurors. The patient and careful manner in which the trial judge conducted the *voir dire* examination was applauded. The defendants specifically raised the question of partiality of two particular jurors, who stated at the *voir dire* that each had some opinion of the guilt or innocence of the defendants (without specifying which) but in response to the trial judge's question each stated that he could adhere to the jurors' oath of reaching a fair and impartial verdict solely upon the evidence presented at the trial.

The Court pointed out that the most that appeared to rebut the presumption of the prospective jurors' impartiality is that they had formed some opinion as to the merits of the case, as the Court would expect of alert citizens of the community, and to hold that such preconceived notion, without more, would rebut the presump-

tion of impartiality would be to establish an impossible standard, the Court here citing *Irvin* v. *Dowd,* 81 S. Ct. 1639 (June 5, 1961). The best that courts can do, it is noted, is to take a prospective juror's word for his impartiality or capacity to overcome a tentative opinion, with the trial judge valuing this word by an estimate of the juror's character and intelligence based upon his general appearance and demeanor under examination.

In short, it would appear that an appellate court, although it must independently evaluate the *voir dire* testimony of the prospective juror under the authority of *Irvin* v. *Dowd, supra,* must of necessity rely to a considerable extent upon the judgment of the trial judge who was able to observe these prospective jurors. This is especially true in situations, as here, where the *voir dire* testimony revealed no more than at best a tentative opinion subject to change, and where there is no public clamor of rage and vengeance whose effect is capable of being independently weighed.

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MOTOR VEHICLES—OWNER OCCUPANT—IMPUTED NEGLIGENCE. *Miller* v. *United States,* 196 F. Supp. 613 (1961).

The noteworthy issue before the Court in this case was whether the negligence of the husband-operator of the wife's vehicle could be imputed to the wife riding as a passenger. The collision with a U. S. Government vehicle, and resultant injuries, occurred while the plaintiffs, husband and wife, were returning home from their work in the family business which both owned, and the vehicle was being operated for their mutual benefit. At the time of the collision the husband was driving an automobile owned by his wife, who was riding as a passenger in the front seat. The Court found that both the defendant's operator and the plaintiff husband were negligent, and was then faced with the problem of the husband's negligence affecting the owner-passenger's right to recovery. The Court found the husband's negligence imputable to his wife.

The Court pointed out that the point to be considered in determining whether the operator of a vehicle will be held to be the agent of the owner riding as a passenger, thereby imputing the operator's negligence to the owner-passenger, is whether the owner has relinquished the *right* to control the operation of her vehicle.

The Court noted that under Massachusetts law there is a *prima facie* presumption that the owner-passenger has retained the right

to control the operation of the vehicle. The Court indicated that the present case is governed by *Guy* v. *Union Street Railway,* 289 Mass. 225, and found that, although the wife-owner-passenger in fact did not exercise any control over her husband-operator, with respect to his method of operation or direction of travel, she was an experienced driver, riding in the front seat, awake and in no way disabled, and concluded that the wife did not surrender control of the vehicle. The Court cited many jurisdictions in accord with the Massachusetts rule and indicated that Pennsylvania, in a husband-wife situation as here, reaches the opposite conclusion on the theory that the husband, as head of the family, is in control even while driving his wife's car. The Court also distinguished several Massachusetts decisions in which a surrender of control was found.

This decision, while not enunciating any new principles of law, serves as a reminder that the matter of the owner-occupant's control, which arises with some frequency, and resultant imputation of negligence, is a presumption, not always easily overcome, and the superimposition of the husband-wife relationship on the operator-owner status seems to make no difference in the result.

☆ ☆ ☆ ☆

PRACTICE AND PROCEDURE—FEDERAL—CONTINUANCE—DISMISSAL OF ACTION. *Alamance Industries, Inc., et al.* v. *Filene's,* 291 F. 2d 142 (1961).

The Court here was faced with a matter that is of great and abiding interest to trial lawyers everywhere, that of disposition of cases on the courts' trial lists.

This is a case of alleged patent infringement where the plaintiff, owner and manufacturer under the patent, brought infringement suits against various retailers in various courts. There was also pending a declaratory judgment proceeding in North Carolina against this plaintiff relative to the validity of the patent, and apparently the plaintiff's efforts had been directed toward the preparation of that action, which could not be expected to be ready for trial for four or five months as of September, 1960, when the defendant took steps to have this present action in the United States District Court here in Massachusetts brought to trial.

Explaining the preparation that had gone into the invalidity proceeding in North Carolina, and having offered to be bound by that decision on validity, the plaintiff moved to stay this Massachusetts action pending the North Carolina trial. After discussion, the

District Court judge offered the plaintiff the choice of trial in sixty days or dismissal of the action with prejudice, being "a judge that disposes of business promptly for the public interest regardless of the private interests."

Although the plaintiff brought a subsequent motion to dismiss without prejudice on the condition that the "plaintiffs shall never again sue the defendant Filene's," which also was denied, the Circuit Court of Appeals reviewed the correctness of the District Court judge's decision as of the date of presentation of the motion to stay proceedings.

While agreeing that so many suits by the plaintiff were a cloud over the industry, a reason proposed by Filene's in moving for trial, the appellate court felt strongly that the action of the District Court judge was error.

The Circuit Court stated:

> "Apparently what principally lay behind the District Court's determination to try the case is to be found in its remark, made at the first hearing (on the motion to stay proceedings), that the 'public interest' of not having a case lie on its docket for fourteen months must control 'regardless of private interest.' We cannot accept this statement either as the formulation of a generally applicable principle or as a proper criterion for the disposition of this particular case. Courts exist to serve the parties, and not to serve themselves, or to present a record with respect to dispatch of business. Complaints heard as to the law's delays arise because the delay has injured litigants, not the courts. For the court to consider expedition for its own sake 'regardless' of the litigants is to emphasize secondary considerations over primary."

(The Court then added by footnote):

> "We do not, of course, mean by this that the court does not have an interest in disposing of its docket. But that is not to say the calendar is to be a mechanical measure."

The Court noted that there is no absolute right to a dismissal on terms under Fed. Rules Civ. Proc. 41 (a) (2) and that whether and upon what terms a dismissal without prejudice may be granted is a matter left initially to the trial court's discretion. Here, however, the Court found that the District Court judge did not even purport to exercise discretion. The appellate court, finding that the parties in interest would not be adversely affected, vacated the findings and judgment of the District Court, and ordered that if the

plaintiff moved again to dismiss with no further action against Filene's, that motion should be allowed.

This decision points out that, although there can be recourse from a trial judge's handling of his trial list, plaintiffs clearly do not have the freedom under Federal procedure to institute and then discontinue suit on their own volition as is afforded under our state procedural system.

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PROBATE—COUNSEL FEES—INSOLVENT ESTATE. *Rose Alma Cloutier, executrix* v. *Raymond E. Lavoie et als.,* Mass. Adv. Sh. (1961) 1173, 177 N.E. 2d 584

The apportionment of counsel fees between probate assets and non-probate assets of an insolvent estate is the problem confronting the Court in this case. It is a point not precisely covered by either case law or statutory law in Massachusetts.

The executrix has appealed from the probate court's decree reducing the legal fees shown in Schedule B of her account from $4500 to $500. There were over $7000 of allowed claims against the estate, and the balance available to meet them would be $156 if the full legal fee had been allowed, and $4156 with the reduced fee.

The executrix and the testator jointly held real estate to the value of approximately $100,000, and no legal fees were paid to the attorney for the estate from this amount, although he filed state and federal estate tax returns and performed valuable service with reference to the jointly held property.

The Court held that in determining what are reasonable counsel fees to be charged to the insolvent probate estate, under G. L. c. 206, § 16, the probate court is entitled to consider the value of those services that directly benefit the probate estate, as well as the fact that the services relating to the non-probate assets were of benefit to the executrix herself as recipient of the non-probate assets. In addition, the probate court can take into consideration the fact that the probate estate was insolvent, regardless of the amount of attorney's fees charged to it, and can reasonably conclude that it was inequitable to charge the small probate estate with the expenses of setting taxes on substantial non-probate assets which creditors of the testator might not be able to reach.

The Court was faced with the practical problem of determining what was fair and equitable to all parties concerned under these circumstances, and related the legislative policy of equitable appor-

tionment of estate taxes between the probate estate and the non-probate assets, as expressed in G. L. c. 65, §§ 5–5B, to the allied but heretofore undetermined matter of similar apportionment of counsel fees. The Court found support of its position in the law of Ohio and New York as well as in some *obiter dicta* contained in *Vaughan* v. *Smith,* 335 Mass. 418.

The Court has expressly limited the principles enunciated here to insolvent probate estates, without intimating what principles would govern a solvent probate estate. A just and fair balance of the various interests of all concerned, certainly including the estate creditors, seems to have been achieved by this decision, and one can foresee other circumstances where the Court's reasoning would apply, even in cases of solvent probate estates.

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TORTS—REJECTION OF NEWSPAPER ADVERTISING.

J. J. Gordon, Inc. v. *Worcester Telegram Publishing Co., Inc.* Mass. Adv. Sh. (1961) 1191, 177 N. E. 2d 586.

The Court in this case has affirmed the right of a publisher of a newspaper to accept or reject proferred advertising as he wishes. It is a question that has not often been before the courts and until now has never precisely been before the Supreme Judicial Court.

Here the Court upheld the sustaining of the defendant's demurrer to the plaintiff's declaration, sounding in tort, which alleged that the defendant's newspapers are a public utility, and being the only newspapers of general circulation in the Worcester area constitute an absolute monopoly therein, and that the defendant, without just cause, maliciously refused to accept the further advertising of the plaintiff, in the real estate business, after having accepted the plaintiff's advertising for over a year.

The Court, after stating that a newspaper is not a public utility, goes on to uphold the independence of the press by following the general trend of decisions from other jurisdictions, asserting that publication and sale of newspapers is a private enterprise and not a business affected with a public interest, thereby relieving newspapers from governmental controls.

Of course, the problem in these circumstances is created for the plaintiff by virtue of the fact that newspaper advertising is of great importance to the plaintiff's business and this medium is virtually closed to him because of the defendant's "monopoly" in the area. However, the Court will not attribute a "public nature" to news-

papers, other than recognizing the existence of a strong interest of the public in their operation, and notes, in support of its holding that here the question is denial of advertising rather than news service, that the plaintiff has not been put out of business by the defendant's refusal and that the defendant's refusal is not in furtherance of an illegal monopoly or other unlawful purpose.

Although it cannot be denied that the plaintiff has undoubtedly suffered damage to its business because of the defendant's actions, under the circumstances of this case the Court was faced with weighing such harm against the broad considerations and manifold repercussions of removing newspaper publishing from the private enterprise area.

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WILLS—BEQUEST OF STOCK—GENERAL OR SPECIFIC. *Ralph W. Igoe, executor* v. *Elinor Darby, et als.*, Mass. Adv. Sh. (1961) 1195, 177 N.E. 2d 676.

The question as to whether a bequest of shares of stock is a specific or a general legacy has again come before the Court.

At the time of the execution of her will, the testatrix owned 76 shares of American Telephone & Telegraph Company common stock, par value $100 a share. She bequeathed 25 shares to each of two of her grandchildren and 26 shares to a third grandchild, and each was also bequeathed items of specific personalty. The will also contained a residuary clause.

Subsequent to execution of her will and prior to her death, the testatrix received 152 additional shares of American Telephone and Telegraph common stock, due to a 3 for 1 stock split, each share having a new par value of $33⅓, so that at the time of her death her estate contained the 76 original shares plus the 152 additional shares.

The Supreme Judicial Court held that the bequest of the American Telephone stock was a specific bequest, and that the three named grandchildren were proportionately entitled to the 152 additional shares. The decision reversed the Probate Court's ruling that the bequest of the stock was a general bequest and that therefore the additional 152 shares should be disposed of under the residuary clause of the will.

While recognizing that a bequest of stock is usually general, the Court points out that this construction is favored to avoid the harshness of ademption of specific bequests. However, the Court pointed out that here ademption is not involved and therefor the

reason for preferring to treat a bequest of stock as a general legacy does not exist. The Court then went on to state that what is here concerned is a rule of construction and that very slight indication of the testatrix's intent to make a specific legacy will prevail. The Court considered that the number of shares bequeathed corresponded exactly with the number of shares owned at the time of execution of her will, and placed considerable significance upon the fact that here an odd amount of stock was involved. The Court found further support in the fact that each bequest of stock was coupled in the same clause with a bequest of specific items of personal property of the testatrix.

Determining that the legacies of the 76 shares of stock are specific, the Court then applied expressly, for the first time in Massachusetts, the rule generally held elsewhere, that additional shares resulting from a stock split go to the specific legatees. It is noted that following the stock split, which is a change of form rather than substance, the testatrix's interest in American Telephone remained precisely the same as it was before the split.

While various rules of construction require various degrees of proof of specific intent to overcome them, it seems clear that the rule of construction here involved can be controverted by as little indication of intent as any, as it is obviously not considered to be a very strong rule.

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